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OCTOBER 26TH-NOVEMBER 1ST 2002

# Restoring Europe's smile

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# Politics this week

Oct 24th 2002
From The Economist print edition

## UNresolved

The United States started canvassing wider support in the United Nations Security Council for a draft resolution on **disarming Iraq**, as France and Russia, both veto-wielding members, persisted in their objections to its tough conditions. After roughly six weeks of negotiations, the Bush administration indicated that its patience was beginning to wear thin.

See article: On a hair-trigger

President George Bush signed into law a huge increase in **defence spending**. The $335 billion bill represents the biggest increase since Ronald Reagan's cold-war build up.

A tenth person was shot dead in Washington's wave of **sniper** killings. Another was injured. A letter to police gave warning that “your children are not safe anywhere at any time” and reportedly demanded $10m to stop the killing spree. Two men were arrested in Maryland in connection with the attacks.

See article: Washington, DC's sniper

The Supreme Court narrowly decided that **executing convicts** who were younger than 18 when they committed their crimes was constitutional; it had earlier decided that 15-year-olds were too young.

**Press freedom** is not necessarily the preserve of rich developed countries, according to a study by Reporters Without Borders. Though the best and worst include few surprises, America, in 17th place, comes in below Costa Rica; Italy, the lowest-ranked G7 country at 40th, sits only just above Mali; and Russia languishes at 121st behind both Sudan and Haiti.

**Free press or repress**
Country ranking of press freedom

| Top five | | Bottom five | |
|---|---|---|---|
| 1 | Finland | 135 | Bhutan |
| | Iceland | 136 | Turkmenistan |
| | Netherlands | 137 | Myanmar |
| | Norway | 138 | China |
| 5 | Canada | 139 | North Korea |

Source: Reporters Without Borders

## Chechen terror

AP

Some 50 **Chechen terrorists** burst into a Moscow theatre, threatening to kill 700 in the audience and blow up the building unless Russia pulled its troops out of Chechnya.

See article: The Chechens strike

**Turkey's** chief prosecutor asked the Constitutional Court to ban the conservative Justice and Development Party, now leading opinion polls for a general election on November 3rd. Its leader is already barred from standing; the new court case could run for months.

See article: Turkey and its Kurds

A parliamentary election in **Montenegro** brought victory for those who want a complete split from Serbia, its partner in what is left of the old Yugoslavia.

In Britain, attempts continued to avert a strike by the **firemen's** union over a 40% pay claim reminiscent of 1970s labour militancy.

See article: Tony Blair and the unions

Britain's education minister, Estelle Morris, resigned making a **rare admission** of political shortcomings. Recent blunders included tampering with exam grades.

See article: Blair's education chief goes

**The Netherlands** fixed January 22nd for a fresh election following the collapse of its short-lived three-party coalition government.

## Hunting the bombers

Indonesian police said they were hunting for three Indonesian men in connection with the bombing of **Bali's** nightlife district that killed more than 180 people, mostly foreign tourists. They were also waiting to question Abu Bakar Basyir, leader of a Muslim militant group, Jemaah Islamiah. He was taken ill after the Bali attack.

See article: South-East Asian terror

In the **Philippines** police arrested five men said to be members of Abu Sayyaf, a group believed to be linked to Jemaah Islamiah. Twenty one people have died in bomb attacks in the Philippines this month, among them an American soldier.

Paulo Pinheiro, the UN human-rights envoy to Myanmar, met **Aung San Suu Kyi**, the country's pro-democracy leader, for the first time since her release from house arrest in May. They discussed the possibility of talks between Miss Suu Kyi and the ruling military junta.

South Korea sent top-level officials to **North Korea** to express alarm about the North's newly-disclosed uranium-enrichment programme. A spokesman said that the North had “listened sincerely”. The leaders of America, South Korea, Japan and China, preparing to attend an Asia-Pacific summit in Mexico, were due to compare notes on what to do next.

See article: North Korea and the bomb

In a new move in its **crackdown on corruption** China said it wanted to arrest Yang Rong, former chairman of the country's largest van maker, for economic crimes. Mr Yang, said to be China's third-richest citizen, is believed to be in the United States.

## Looting continues

A UN report accused **Rwanda** of continuing to loot eastern Congo's minerals, even after its army officially withdrew from the country earlier this month.

Mass graves were found in **Guinea**, a human-rights group said, suggesting that the late dictator and liberation hero, Sékou Touré, killed even more people than hitherto thought.

A senior State Department official, William Burns, toured the **Middle East** to promote a “road map” for Palestinian-Israeli peace. Sceptics scoffed that America simply wants to keep the conflict quiet while focusing on Iraq.

See article: Israel

**Bahrain** held its first general election since 1975. Opposition parties of the majority Shia sect boycotted, protesting a decree allowing King Hamad to appoint a second chamber with equal power to the elected parliament.

George Bush signed the **Sudan** Peace Act, allowing America to punish the government in Khartoum if it fails to “act in good faith” in negotiations to end its civil war.

## Lula's lead

On the eve of **Brazil's** presidential election this Sunday, opinion polls gave Luiz Inacio Lula da Silva of the left-wing Workers' Party an apparently unshakeable lead of some 30 percentage points over Jose Serra, of the centre-right governing coalition.

See article: Lula on the brink of Brazil's presidency

More upheaval in **Venezuela**: a group of senior military officers staged a protest in which they called for the resignation of President Hugo Chavez. He ignored them.

See article: Venezuela's frustrated opposition

In **Ecuador's** presidential election, voters rejected traditional politicians and backed Lucio Gutierrez, a left-wing former colonel and coup leader, and Alvaro Noboa, a banana magnate. The pair face contesting a run-off ballot on November 24th.

Reuters

See article: Ecuador's trend-confirming election

**Colombia's** wars came to the cities: in Medellin, government troops retook a slum district from FARC guerrillas after two days of fighting in which 14 people died. In apparent retaliation, a car bomb near Bogota's main police station killed two and injured 38.

See article: The new turn in Colombia's conflicts

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# Business this week

Oct 24th 2002
From The Economist print edition

## ABB's affliction

**ABB** teetered on the edge after its shares plunged by over 60%. The Swiss-Swedish engineering group issued a profits warning and revealed that it could not afford mounting asbestos liabilities. America's Supreme Court had stymied its bid to stop future asbestos claims. In a bid to avoid bankruptcy ABB announced a reorganisation of its businesses, cost cutting and disposals.

See article: ABB and asbestos

The world's largest media company, **AOL Time Warner**, announced that it would restate two years of results for America Online, which bought Time Warner in 2000. An internal investigation found that AOL, currently under scrutiny by the Securities and Exchange Commission and Department of Justice, overstated online ad revenue by some $200m.

See article: AOL Time Warner's controversial merger

A German utility, **EON**, bought the British electricity-generating business of TXU, an American power firm, for *euro*2.2 billion ($2.1 billion). TXU is hastily pulling out of European activities to safeguard its troubled home operations.

**Pfizer** filed a lawsuit attempting to block rival drug makers, including GSK and an Eli Lilly joint-venture, from launching anti-impotence drugs that use the same active ingredient as its own product, Viagra. A similar case failed to stand up in a British court.

See article: Eli Lilly's pipeline full of new drugs

**Virgin Atlantic Airways** paid £13,000 ($20,100) to compensate a woman for injuries sustained after she was squashed by an obese passenger in a neighbouring seat on a transatlantic flight.

## Adobe building

**Adobe Systems**, creators of Acrobat, a free and ubiquitous online document-distribution system, launched new (but not free) software that will allow customers to complete and sign forms online. Digital signatures will allow an array of new online transactions; another step towards the fabled paperless office—though trees would be unwise to start celebrating too soon.

The **Internet** suffered a big attack. Nine of the 13 root servers that guide traffic around the system were flooded with a deluge of spurious data intended to bring services to a halt. However, the assault lasted for only an hour, leaving most users unaffected.

See article: Securing the cloud

## Legrand delusion

The EU's second-highest court ruled that the European Commission was wrong to block a merger between two French electrical-goods companies, **Schneider** and **Legrand**, citing “errors and omissions” in the commission's reasoning. The judgment, weeks after a similar rebuff, prompted calls for a radical

overhaul of the system; the commission plans to appoint a chief economist and improve scrutiny.

See article: Mario Monti of the European Commission

**Vivendi Universal** confirmed that it would sell its non-American publishing businesses to **Lagardère**, France's second-largest publisher, for *euro*1.25 billion ($1.2 billion). Competition watchdogs will take a keen interest; the acquisition could allow Lagardère to dominate in France.

**Pinault-Printemps-Redoute**, a French retail conglomerate, said that it would sell Finaref, its consumer-finance arm, for over *euro*3 billion ($2.9 billion). PPR is also likely to hasten the sale of other units to cut debts of around *euro*6 billion as it attempts to finance a purchase of the 47% it does not already own of Gucci, an Italian fashion house, for some *euro*5 billion.

The French government, never keen to privatise overhastily, said that it would postpone the sale of a further slice of its 54% stake in **Air France** by up to a year to give stockmarkets time to recover. The government's share is likely to fall below 20%.

## Conflicts of interest

**CSFB**, Credit Suisse's investment-banking arm, found itself on the wrong end of a civil lawsuit. Financial regulators in Massachusetts accuse the bank of issuing fraudulent research and are demanding a separation of research and investment banking plus a possible $100m fine. CSFB claims that this would hinder Wall Street's efforts to negotiate an industrywide solution.

Britain's Financial Services Authority, perhaps lacking some of the urgency of American counterparts, launched an investigation into "**spinning**"—handing out shares in sought-after IPOs in return for banking business. Its first piece of detective work: a letter to banks asking if that sort of thing really went on.

## Recovery postponed?

**America's** index of leading indicators fell in September for the fourth month running. Unless the recent stockmarket rally is sustained, growth prospects look dim.

A long-awaited plan to deal with **Japan's bad-loan problem** by a government taskforce failed to materialise amid suggestions that senior politicians in the ruling Liberal Democratic Party had found the proposals too stern to consider.

See article: Japan's economy

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The European Union

# Restoring Europe's smile

Oct 24th 2002
From The Economist print edition

**These are not the best of times for the European Union. Here's why**

Get article background

LESS than a year into its historic single-currency adventure, the European Union is finding the going tough. The EU's biggest economies are struggling, and this is not just bad luck: the economic-policy framework that the EU put in place to oversee the new regime is a chief culprit. In foreign policy, the Union is divided, with Britain supporting George Bush over Iraq, while France, Germany and others question American aims and methods. The celebrations that followed the Irish referendum on the Treaty of Nice—having voted against last year, the Irish changed their minds on October 19th—did not last long. The vote was supposed to open the door for newcomers (see article), but things are not so simple. Other obstacles have to be cleared first. And this is to say nothing of divisions over another grand ambition, to frame a new European constitution.

What else is new? In Europe, you might say, turmoil like this is business as usual. Europe's model of change has long been based on lurch then muddle. And it works. The EU's boldest initiatives—the single currency, for instance—have been shaped by a grand vision and an insatiable appetite for innovation among the Union's leaders (rarely among its citizens) together with an equally impressive tolerance of loose ends. Get the agreement and damn the details. Sort problems out as you go. Voters may not like it at first, but they will come round.

When you look at what the EU has achieved, as a self-propagating organism if in no other way, who is to say this rough-and-ready method has failed? But perhaps the drawbacks of muddling through are growing. Economic policy certainly points that way.

## Not the best design

The Stability and Growth Pact is stupid, Romano Prodi, head of the European Commission, confirmed last week in a lapse of propriety. He was right, obviously—hence the rending of garments in Europe's capitals. What word better describes a regime that tells economies in recession to raise taxes and cut spending? The pact should be redesigned, or else ignored, but such stark alternatives are frowned on by lurch and muddle. A redesign may require a new treaty, not scheduled until 2005; and discarding the rules in the meantime would make a mockery of the whole thing. So Europe will rub along with the pact and semi-comply, destroying many jobs, albeit not as many as strict obedience would destroy (see article).

Or consider the European Central Bank. In accordance with lurch and muddle, the treaty that created the single currency told the ECB to work out for itself minor details such as what its objective, “price stability”, actually meant, and how open and accountable to public opinion the bank would be.

As it turns out, the bank has chosen to adopt both an extraordinarily secretive approach to its deliberations and a notably austere definition of “price stability”—taking this to mean average inflation across the euro area of less than 2%. This target is especially demanding for the euro area, which includes poorer countries that are growing relatively quickly from a low starting-point,

**Enlarging the Union to 25 members or more will pose an even**

and which may therefore have higher inflation than average. In practice, the ECB has let inflation exceed its target. Quite right: if the bank had been more rigorous, interest rates would have been higher and the European economy weaker still. But was this the best way to proceed? Rather than adopting a too-demanding target, missing it and failing to explain itself—muddle upon muddle—the bank should have adopted, or been given, a realistic target that it could actually set out to hit. That would have been a lot easier to explain to the public, too.

**bigger challenge to the lurch-and-muddle approach than the single currency**

Enlargement from a Union of 15 members to one of 25 or more will pose an even bigger challenge to the lurch-and-muddle approach than the single currency. No question, this influx of mainly poor economies is welcome in itself; indeed, it is scandalously overdue. But it is going to expose very cruelly these and other loose ends in the EU's institutional design. One question looms especially large: will it be possible to sustain the common agricultural policy (which makes the stability pact look like a model of lucidity and good sense) once the newcomers are in? France, at least, appears to think the answer is yes. It is to be hoped that France is wrong. In any event, it would be better for all concerned to answer the question sooner rather than later.

## Gather round the drawing-board

Work on a new constitution for Europe might yield a new and better method of institutional design, and set much of this to rights—or it might fall prey itself to lurch and muddle. A convention presided over by Valéry Giscard d'Estaing has been charged with producing a draft, and a first sketch of what it might contain is expected next week.

*The Economist* has already tried its hand at sketching such a document (see our issue of October 28th 2000, available at www.economist.com/constitution). In our view, the goal should be to bring clarity and stability to the framework within which the EU makes political choices, while strengthening the role of national parliaments and Europe's citizens. Politics will still be messy under the settlement we have in mind—this is important; politics should be messy—but we seek two key advantages over the traditional approach.

First, no more lurches—not for a long time, anyway. In future, far-reaching constitutional changes should be separated by decades, rather than the years or months the EU has come to regard as normal. With that in mind, we propose that the EU's goal of “ever closer union”—a commitment to permanent constitutional revolution—be expunged. Second, we want less of the wrong kind of muddle (which arises when the Union interferes needlessly with the preferences of member states, seeking uniformity where none is required) and more of the right kind (which is the untidiness that arises from variety and competition among national policies). A strong, explicit and enforceable principle of subsidiarity is therefore the core of the constitution we would like to see.

***The Economist* proposes that the EU's goal of “ever closer union”—a commitment to permanent constitutional revolution—be expunged**

To judge by recent interviews, Mr Giscard d'Estaing is open to such ideas. But there are grounds for concern. Many of the delegates to the convention want to enlarge the EU's constitutional ambitions, and indeed to strive for the fastest possible movement towards a United States of Europe (a proposal to make that the EU's new name has been tabled, by the way). A common foreign policy, notwithstanding those slight differences over Iraq, is a cherished goal. And Europe's leaders seem largely uninterested in the need for constitutional stability and a subsidiarity principle with teeth. Instead they are preoccupied with whether the European Council should have an appointed president, rather than let the job be passed round every six months, as now. One can see why this engages the interest of possible candidates, but the issue is unimportant (unless it becomes a downright bad idea, as it would if it led to a compensating increase in the power of the European Commission, which the commission is demanding).

Evidently, lurch and muddle is not dead yet. The drawbacks, though, are getting too painful to ignore. For Europe's sake, the new constitution must depart from this outmoded tradition, not honour it.

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Dealing with Iraq and North Korea

# Time is danger

Oct 24th 2002
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**America is pressing the UN for Iraq to be disarmed. North Korea shows why**

AP

THIS week the haggling dragged on at the United Nations Security Council over the precise terms under which Iraq should be told, one last time, to rid itself of its weapons of mass destruction. France and Russia have formed their own axis of awkwardness to delay an American-sponsored resolution, casting doubt on whether forceful action would ensue should Iraq refuse to comply. Meanwhile, though, another proliferation bombshell shows why a failure to deal with Iraq would not only destroy the council's credibility, but threaten the international peace and security it is meant to uphold. North Korea's admission, when presented by America with damning evidence, that it has been enriching uranium for a second illicit nuclear-weapons programme (the first used plutonium) is a chilling reminder of why the thorough frisking of Iraq, however it comes about, will come not a moment too soon.

Both Iraq and North Korea have long flagrantly violated their non-nuclear promises under the Nuclear Non-Proliferation Treaty and have plenty of other nasty weapons too. One difference between them is that after its 1991 defeat in the Gulf war, Iraq's weapons programmes were partly dismantled by UN inspectors. Saddam Hussein has had four years since he turfed them out to rebuild much of his terrifying arsenal. But it is thought he still does not have a nuclear bomb. North Korea's leader, Kim Jong Il, has shown what can be done unfettered: he may already have one or two bombs and could quickly make several more.

Unlike Iraq, which insists it has no weapons to give up, North Korea says that it wants to negotiate with America about its latest bomb tinkering. America, too, is keen to find a diplomatic solution. President George Bush will this week meet China's president, Jiang Zemin, at his Texas ranch and then go on to an Asia-Pacific summit in Mexico to compare notes with South Korea's Kim Dae-jung and Japan's Junichiro Koizumi, his two closest allies in the region, and with Russian officials. None of these four countries, North Korea's neighbours, has an interest in leaving its unpredictable regime free to brandish a nuclear weapon. America will need help from all of them if North Korea is to be persuaded out of the weapons of mass destruction business. Can it be done?

When inspectors from the International Atomic Energy Agency first fingered North Korea for secretly producing plutonium, America got no help in holding the regime there to its non-nuclear promises: the neighbours deemed even economic pressure too provocative. So in 1994 America was left to negotiate a deal that froze North Korea's plutonium production in return for two western-designed, less proliferation-prone nuclear-power reactors (paid for mostly by South Korea and Japan) and interim deliveries of oil. That capped a nuclear threat that would have grown; and for the reactors to be finished, North Korea would eventually have to come clean about its past nuclear dabbling. Yet putting off the day when it had to submit to proper inspections—Iraq foot-draggers, take note—gave it time to perfect its bombs and to build ever farther-flying missiles to mount them on. Whatever the risks in confronting North Korea in 1994, they are more daunting now.

## Pulling together

North Korea had long been suspected of wanting the economic benefits of the reactor deal, but not inspections. Time for these is now fast approaching. Provocative missile tests might have been tried as one America-trumping possibility; the alternative uranium route to a bomb was no doubt meant to be

another. An angry North Korea now says the 1994 deal is “nullified”. That may be another negotiating ploy. But if diplomatic push does come to undiplomatic shove, and either side walks away from the agreement entirely, North Korea could quickly get its hands on more plutonium in its own mothballed reactor-fuel rods to make more bombs.

So it must be hoped that North Korea really is ready to trade in its uranium programme, its missile production and other threatening things for aid, trade and better relations. Such a comprehensive deal has been the aim of the Bush administration for more than a year. North Korea has already started to reform its economy, accepting that it needs help from South Korea, Japan and America, as well as China and others to survive.

Yet Kim Jong Il, like Saddam Hussein, is a serial shredder of promises. An essential component of any new deal would have to be intrusive inspections to ensure that it is kept. And if North Korea still refuses? The other essential component, if diplomacy is to work, is for America, South Korea, Japan and China all to deliver the same message: if aid and trade is to flow, North Korea's weapons of mass destruction must go, and verifiably. In dealing with North Korea, as with Iraq at the UN, the trick is to pull together, not be pulled apart.

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Teaching with computers

# Screen it out

Oct 24th 2002
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### No real help, and sometimes harmful

Alamy

FIRST it was the movie, then the radio receiver, and then the television. Each was once seen as magical technology that would transform children's education. Now it is the computer. Politicians everywhere promote computers as a way to replace the boring old blackboard and sometimes a few boring old teachers too, by improving their productivity. The arrival of the Internet has stepped up the pace. Billions of dollars have gone to clutter classrooms with terminals and keyboards. Companies (including Pearson, part-owners of *The Economist*) wax lyrical on the potential of educational software. And a mountain of studies demonstrates the impact of these wondrous machines in school.

Except that they don't. Hardly any studies compare classes of children taught with and without the help of computers—and none randomly allocates children into differently taught groups, as a medical trial would do. So the billions have been spent on a hunch. Some thought that installing computers was a good way to teach children to use the things, and thus fit them for the 21st century. In fact, as every parent knows, the average ten-year-old understands far more about computers (and indeed the Internet) than the typical rocket-scientist. Many more thought that teachers would find computers useful tools for instruction in other subjects, such as maths or languages. But a new study, using evidence from Israel, now contrasts children whose teachers do and do not use computers in the classroom (see article). It strongly suggests that the hopes for computers are just as wrong as those for classroom movies, radio and television. Worse, it picks up signs that computers may even impede learning: fourth-graders taught maths with the help of computers appear to do worse than similar fourth-graders taught without them.

Could the explanation be technophobia on the part of either teachers or students? Unlikely, says Larry Cuban of Stanford University, who has studied computers and education for many years. Almost all teachers and pupils have at least one computer at home these days. Moreover, although teachers and children rarely use computers—or use them effectively—in the classroom, both groups use computers a great deal at home for schoolwork. And, indeed, this is hardly surprising. Classroom computers can be disruptive. They rarely enhance the studious atmosphere in which children are most likely to learn. The new conventional wisdom is that young children in particular learn best when they face the teacher. But computers encourage children to split into noisy little groups. And one of the vaunted advantages of computer-based learning, that it allows children to proceed at their own pace, has so far turned out to be wrong: educational software is much more one-size-fits-all than a good teacher, skilled at tailoring the lesson to the varied abilities of a class.

## Lesson one: teachers before technology

The billions that have financed computers in classrooms have therefore been money not spent on textbooks or teachers. The Israeli study puts the cost of installing computers at about one teacher a year per school. Ironically, while the educational effectiveness of computers is doubtful, good evidence suggests two other ways to spend money on schools that yield clear benefits. One is to cut class size; the other, to improve teacher training. But then, what politician wants an old-fashioned answer like that?

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Digital security

# How to worry wisely

Oct 24th 2002
From The Economist print edition

**Securing computer systems is important, but not for the reasons you might think**

VIRUSES that spread by e-mail. Hackers who deface websites. Theft of credit-card details and customer lists. Follow the subject of computer security too closely, and you might be forgiven for never wanting to touch a keyboard again. Industry experts, government officials and technology firms issue endless alerts, fixes and guidelines, call for more spending on security, and even give dark warnings of cyber-terrorists poised to wreak havoc with a few clicks of a mouse. Just this week, mysterious online attackers tried to paralyse the Internet by flooding crucial "root server" computers with bogus traffic. Something must be done, and quickly.

Oh, really? Most people who use computers have probably experienced nothing more sinister than an occasional virus. Typing your credit-card number into a web page, once considered an act of near insanity, has become routine. Has the website of the company you work for been defaced recently? No, we didn't think so. Attacks similar to the one that occurred this week happen quite often, and nobody notices.

The truth, of course, lies somewhere between these two extremes, as our survey on the subject argues in this week's issue. Those in the security industry, like environmentalists, have an incentive to overstate the risks; meanwhile, to the untrained eye at least, nothing much seems to be wrong. So, is the subject of digital security cause for more widespread concern? It is—but not for the reasons that you might think.

It is tempting, for example, to dismiss the sudden emphasis being placed on digital security as a knee-jerk reaction to last year's terrorist attacks. But it is actually part of a much longer-term trend, as the Internet struggles to transform itself from a toy to a grown-up utility, as reliable as gas, water or electricity. There is clearly a long way still to go. As people become increasingly reliant on computers and networks, however, in both their personal and business lives, it becomes more important to make them secure. As for cyberterrorism, it is possible, but unlikely: truck bombs and hoax telephone calls can cause more disruption, far more cheaply and visibly. The security of the Internet needs to be improved, then, but for rather more mundane reasons than the cyber-Cassandras suggest.

The security problems that most people are aware of, and that they are most likely to worry about, are attacks by malicious hackers and viruses. These threats are certainly worth worrying about—a bit. But the reality for most organisations is that attacks by insiders, and the theft of intellectual property by disgruntled employees in particular, do much more damage. Hackers and viruses get disproportionate attention because they can be highly visible, and because there are lots of vendors offering apparently simple fixes. Insider attacks are usually hushed up, and are harder to detect and prevent. Putting the right policies and processes in place to improve internal security is mainly a management problem, not a technical one. So again, there is cause for concern, but the nature of the problem and the solution are widely misunderstood.

## Have a coffee instead

So is the answer for everyone to start spending huge sums on security technology and training? Not necessarily. Most companies, according to a popular industry statistic, spend more on coffee than on

digital security. Yet the real problem may be that the spending is in the wrong places. Security involves balancing costs and risks, and only a proper risk assessment can determine which assets are worth protecting, given the cost of doing so. Such decisions should fall not to the specialists in the systems department, but to senior executives. They need to pay more attention, though not necessarily more money.

It would be no bad thing if people worried a bit more about digital security. As long as they worry about the right things.

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Asbestos claims

# No way to right a wrong

Oct 24th 2002
From The Economist print edition

### Cancerous product, cancerous litigation

WHAT should America do about mass torts? The toll from asbestos litigation continues to mount. ABB, a European engineering firm, is the latest company to face ruin because of work done by a subsidiary that was not only legal at the time, but carried out in the interest of safety (see article). And asbestos is only one cause of such litigation. Tobacco, lead paint and pharmaceutical products are all ripe business opportunities for lawyers, who routinely earn 30-50% of settlements.

A paper published earlier this year by the Council of Economic Advisers estimates that America's tort system soaks up 1.8% of GDP, or $180 billion a year. And for little purpose: only 20% of the money goes to claimants for economic damages. In a number of mass tort cases, courts have begged Congress to intervene. But politicians hesitate. Reform would reduce payments to a constituency that recycles settlement money into political contributions: the trial lawyers.

Certainly, companies must take responsibility for disclosing the known potential hazards of the products they produce, and for shouldering the consequences when they do not. But asbestos does harm in a particularly insidious way. Its horrible cancers and respiratory problems may emerge only long after the statute of limitations has expired, meaning that there may be no redress even for medical costs. This lag has encouraged lawyers to seek huge settlements for people who are not harmed and will never be harmed. The result is not only to wreak havoc upon companies forced to pay the bill, but in effect to limit the compensation for real victims.

Two remedies that are being widely discussed for asbestos could be used elsewhere. The more modest is to create a registry of people who might eventually be able to file a tort claim for exposure to a toxic substance, to preserve their right to litigate beyond any normal statute of limitation. Courts in Pennsylvania and Massachusetts have already begun to do this. But it can only be a partial solution. No one would want to be at the end of the line in cases with huge potential financial settlements, because there may be nothing left when their turn comes. The registry also leaves a huge liability hanging over existing businesses.

A second idea is to address mass torts by creating a giant administrative compensation system, along the lines of the fund for victims of the September 11th attacks. The fund could compensate for economic damage—lost wages and medical costs—rather than for the more abstract “pain and suffering” that largely feeds the plaintiff bar. But cutting out the plaintiff bar would undoubtedly jeopardise passage through Congress.

## Think modest

The best approach would be twofold. First, as suggested by Victor Schwartz of the Campaign for Asbestos Justice, limit litigation to where plaintiffs live, or were exposed, or where the defendant has its principal place of business. That would control the rush to tort havens in Mississippi, West Virginia, Texas and Illinois, where verdicts are most irresponsibly open-handed. Defendants complain that, in a handful of jurisdictions, judges allow the introduction of poor scientific evidence and block depositions by plaintiffs, with devastating consequences. Second, end the consolidation of claims that have little to do with one another. In a recent case in West Virginia, more than 8,000 plaintiffs took 250 companies to court. After

pre-trial settlements, there were still 5,000 plaintiffs when the trial began. Supreme Court rulings may also help.

Solutions exist. But all have one dire weakness: less money for lawyers. Could Congress ever swallow that—even to benefit true victims of corporate carelessness?

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# Letters

Oct 24th 2002
From The Economist print edition

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## Fixing the world economy

SIR – I do not agree that the best way to jump-start the world economy is to lower interest rates ("How to rescue it", September 28th). This will act like morphine, stopping pain and preventing any cure, bringing with it perverse effects which imbalance the economy. When interest payments are near zero, how do you know if a borrower can service a debt? Nobody feels the need to restructure clumsy operations and excess indebtedness. When interest rates are extremely low and equity returns negative, how can financial markets efficiently allocate capital? Break the navigator's compass and nobody knows which way is north. Very low interest rates artificially inflate certain economic sectors (for example, construction in Japan). Other sectors are asphyxiated. Life insurance in Japan, is drowning under high liability costs and ridiculous asset profitability. American pension plans could go the same way.

Perhaps the worst effect is on the household savings rate. The Japanese example shows us that when households cannot get a decent return on savings, they just save more to reach a level of capital deemed necessary for financial security and retirement needs. America has not gone this way yet because households believed until recently that the economy was in a temporary slowdown. Soon, this will change and the savings rate must increase above the historical average, bringing with it a nasty surprise.

Eric Berloty
New York

SIR – Credit expansions and asset-price booms tend to be self-reinforcing, because, as you say in your survey of the world economy (September 28th), "rising asset prices boost growth and make it easier to borrow by raising the value of collateral." This peculiarity of asset finance suggests that one solution could be introducing a dynamic stabiliser that changes the effective loan-to-value ratios automatically and countercyclically. Applying a simple asset-valuation rule would directly restrict credit to booming asset markets and have a symmetric mitigating effect in downturns, when easing the monetary stance is often like "pushing on a string".

Under this rule supervisors should require financial institutions to value assets using a long-term moving average when they are pledged (explicitly or implicitly) as collateral for new credit.

Tentatively, I suggest a ten-year moving average to reflect a full asset-price cycle. The rule is well suited to deal with divergent developments in different categories of assets, and of countries or regions under a common monetary regime.

Amos Rubin
Jerusalem

SIR – There is not much mystery to the business cycle. Most cycles are endogenous and easily explained by the inertia of a complex economy. I was reminded of this phenomenon during a recent breakfast visit to a pancake house. I walked into the restaurant very hungry (recession), quickly devoured a stack of five pancakes laden with butter and syrup (boom) and walked out vowing never to eat another meal again (bust). An equilibrium of full employment, stable prices and adequate domestic savings was never experienced.

Dennis Ducote
Houston, Texas

SIR – The master of the sailing ship depicted on your cover is not overly concerned about finding himself in the doldrums (September 28th). Had he been, he would have hung every rag of canvas he owned on her, right to the stuns'ls, and would have had the hands wetting it all down in the hope of catching even the vaguest of breezes.

Mark Wilson
Manchester

## Opus operative

SIR – I am a Spanish priest who spent 13 years working in different apostolic initiatives of Opus Dei ("A saint for Opus Dei", October 12th). I got to know policemen and fire fighters in Chicago, students in Evanston, seamen in Texas, farmers and store keepers in Indiana, and Filipino immigrants in California. Some I met again in Rome at the canonisation of Josemaria Escriva de Balaguer. We laughed, we cried with emotion, we prayed and we felt strengthened in our common faith. Given your coverage, is it that you do not understand or is it that you simply do not like us?

Claudio Urbano
Pamplona, Spain

## Death in DC

SIR – While dispassionately assessing the risks of falling victim to the sniper active in and around Washington, DC, you do little to reassure my mother in California ("The logic of irrational fear", October 19th). My wife and I live in Prince George's County, which, as you say, accounts for three-quarters of the area's "ordinary" murders.

The District of Columbia has long contended for the lead in the national murder rate, and Prince George's County is adjacent to the most impoverished and dangerous part of DC. The national murder rate is 5.7 per 100,000 population; the District of Columbia's rate is 46.4 per 100,000, of which the bulk occur in the central and the south-eastern portion, which neighbours Prince George's County.

Although, for the sake of analysis, one must put geographical boundaries somewhere, it is worth noting that the south-eastern portion of the district and the part of Prince George's County immediately adjacent have exceptionally high murder rates, giving the impression that the rest of Prince George's County and DC are more dangerous than is the case. If only for my mother's sake.

Karl Bilawski
University Park, Maryland

## Unfair to Uzbekistan

SIR – Your article on Uzbekistan ("The European Bank for Repression and Dictatorship", October 5th) reads like propaganda. It has problems but you confuse measures that address legitimate security concerns in an unstable part of the world with repression.

Furthermore, Uzbekistan is a member of many international organisations. Its co-operation with the European Bank for Reconstruction and Development dates back to independence in 1991 and is aimed at reforming and liberalising the economy. The planned meeting of the EBRD in Tashkent in 2003 is a sign that Uzbekistan does not shy away from the outside world and is ready to welcome many participants, probably including critics of the country. As a long-standing foreign resident, I have to say that describing Tashkent as joyless ignores reality.

Ronald Kennedie
Tashkent

## Lights, camera, privatisation

SIR – The most important factor in the renaissance of the Mexican film industry is that the government privatised the industry a decade ago ("The Mexicans are coming!", October 5th). Until then, political authorities were responsible for writing, directing and distributing films. The Mexican case clearly shows that markets have better taste than bureaucracies.

Jose Loyola
Washington, DC

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Central Europe

# Westward, look, the land is bright

Oct 24th 2002 | BRATISLAVA, BUDAPEST, PRAGUE AND WARSAW
From The Economist print edition

**The European Union is now formally embarking upon enlargement. For Central Europeans, however, the end of history may prove disappointing**

PAINFUL history is not hard to find in Central Europe. World wars, totalitarianism and genocide have been played out on its soil. Yet think also of Poland, which vanished from the map for more than a century. It re-emerged amid the ruins of the first world war only to be brutalised again during the second, then waited until 1989 for the freedom, once again, to make its own way. Stubbornly, this part of the world has a knack of rising again. Soon, thanks to Ireland's approval last weekend of the Nice treaty, its next reincarnation will appear.

In December, the European Union is due to finish negotiations with ten hopeful members which, save Cyprus and Malta, were all former satellite states of the Soviet Union. Poland, Hungary, the Czech Republic, Slovakia, Slovenia and the three Baltic states will—perhaps by 2004—at last take their places as full members of Europe's top club. History, you might say, is coming to a happy end.

Eastern Europe was mostly a conceit of the cold war, based on Stalin's lumping together of everything to the east of the Iron Curtain. But Central Europe, the name now preferred by many locals, is itself rather new, having come into use only about a century ago. And it, too, conceals huge differences. Despite fitful attempts to progress, Bulgaria and Romania remain, like Ukraine, firmly in the East. By contrast, Slovenia looks little different from rich neighbour Austria, and is essentially western. The Baltics are tiny; besides, Estonia is practically Nordic in all but income. That leaves a Central Europe of Poland, the Czech Republic, Hungary and Slovakia, which now make up the first tranche of Europe's eastward enlargement.

In many ways, these four have already come most of the way home. Three of them—Poland, Hungary and the Czech Republic—joined NATO in 1999. The Slovaks will probably do so after the NATO summit in Prague this November. Unlike their eastern neighbours, such as Russia and Ukraine, none has spent much more than 40 years under communism. Since the tumult of 1989, all have become stable, if rowdy, democracies with workable market economies.

The heroes of that fateful year have now passed, or are about to pass, from the scene. Poland's Lech Walesa has more or less gone from politics after a brutal defeat in the presidential election of 2000 and the collapse of the rump of his movement, Solidarity. The Czechs' Vaclav Havel, who has been very ill, will retire in January to write his memoirs, having fulfilled his two five-year terms as a figurehead president. Hungary's Viktor Orban, who in 1989 famously stood at the tomb of a leader of an earlier uprising to demand the departure of Soviet troops, has tilted towards the nationalist right; his Fidesz party, which once catered to Hungary's yuppies, has lost power. Each such farewell is a sign of the maturity and health of these democracies. Politics in these parts has indeed come a long way.

Yet all is not well. Dashed hopes and disaffection mark much of Central Europe. The losers, and there are many of them—farmers, factory workers, the unemployed young—are angry. Pensioners struggle to get by on sums lower than the World Bank's poverty standard. What happened, they ask, to the much anticipated perks of capitalism and liberal democracy? One Budapest resident puts it this way: “Stop any BMW driving on the street. There's about a two-thirds chance [the driver] is connected to ex-communist-party men and secret police officers.” Much of the new wealth has shady origins, corruption is endemic, and the quality of Central Europe's politicians, civil servants and judges is poor to dire. Some former dissidents are understandably upset. Surely, they say, we didn't go to prison so that communists could shop at Boss, or in order to fill our television screens with naked weathergirls and dubbed Jerry Springer shows?

Anger bubbles up in two ways. Right-wing populist parties have gained ground, most dangerously in

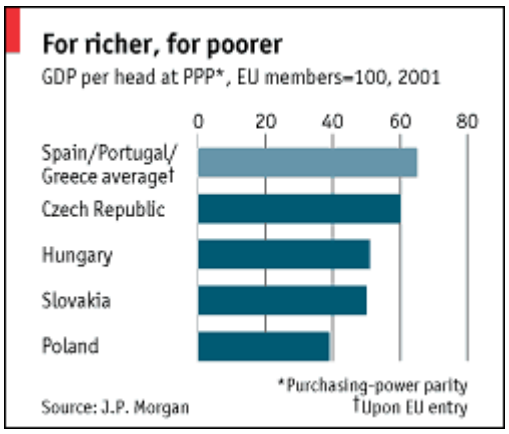
Poland. Thanks to parties such as Self-Defence and the League of Polish Families, the result of a forthcoming referendum on joining the EU is far from certain. Ex-communists have exploited the fears of those who may lose out, and have appealed to nostalgia for the good old days when everyone had a job. But in most of Central Europe politicians of the old order have done a brilliant job of reinvention during the past decade, with parties becoming fairly close facsimiles of West European social democrats, warts and all.

So successful, in fact, that Central Europe's governments are almost entirely run by the left. In Poland's current left-wing coalition, both the prime minister and the president served as communist-era ministers. Harder-core leftists, such as the Czech Communists, unreformed and unapologetic, carried several regions in the June election, including the wine-growing bit of the country along the border with Austria. Ironically for a Walesa or a Havel, it is the political heirs of their oppressors who will lead these countries into the EU. Democracy can take strange turns.

## The second-class compartment

The last time the EU expanded, in 1995, only rich countries were up for membership. Sweden, Finland and Austria all slipped in effortlessly. You have to go back to Spain and Portugal in the 1980s for a rough analogy of the task ahead, though this time it will be harder. Central Europe—with a combined population of 64m and a GDP of $300 billion—is far poorer per head than even the Iberian countries and Greece at the time of their EU entry (see chart). With EU budgets already strained, Central Europe will receive far less money from Brussels than the Spaniards did. And if Poles, Hungarians, Czechs and Slovaks are expecting a big boost in private investment in its place, they may be sorely disappointed: much foreign direct investment has already arrived, and accession will not bring massive increases.

Negotiations over the *acquis communautaire*, the EU's body of laws, are plodding towards a conclusion, though the most important questions, including farm subsidies, are still to be resolved. Poland, for example, has 27% of its workers in jobs connected to farming. The level of aid for Poland's smoke-belching steel industry is another sticking point. The candidates must close all chapters by December to allow formal accession in 2004. Yet member countries, notably France and Germany, are grumbling. Recent economic weakness and budget deficits among the candidates suggest that accession may slip to early 2005, if not later.




Whenever it comes, Europe's new members will, in some respects, be second-class citizens. Austrians and Germans, in particular, fear a flood of new migrants snapping up jobs. This is unduly alarmist. First, the Germans need such immigrants to help prop up their teetering pension schemes and boost their flagging high-tech sector. But most Central Europeans are stay-at-homes. Few would move from one side of Hungary to another, much less to Berlin, in search of a better job. Even so, restrictions on labour will remain for up to seven years after accession, though Finland and the Netherlands are looking to open their borders to the newcomers sooner.

Since 1989, trade has shifted strongly towards the west. Income levels have grown throughout the region. Investment in everything from car plants to breweries has streamed in. The Central European economies are said to be converging with those of their western neighbours. Even at robust rates of growth, however, Central Europe's EU candidates may need as much as another 15 to 20 years to catch up with Western Europe. Growth has in fact been slowing in much of the region. Governments are backsliding on economic reforms—a pity, since sluggish growth may not only delay the candidates' own accession, but jeopardise the chances of the remaining aspirants to the east.

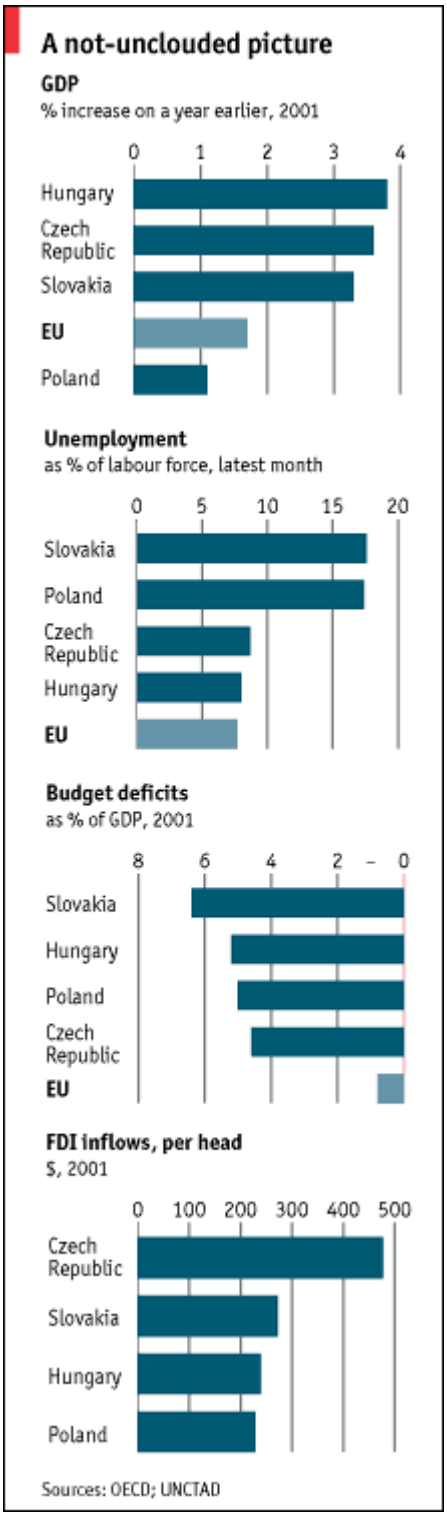
Impressive industrial growth can be seen all over Central Europe. Philips has moved some TV manufacturing to Hungary from China to take advantage of a cheap but well-educated workforce, and Gideon Richter, a pharmaceutical firm, produces generic drugs there on a grand scale. In the Czech Republic, Skoda, a car maker, has tripled production since Volkswagen bought the company in 1991, when 70% of its cars were sold domestically. Now 80% are exported, to some 70 countries. Skoda has plants in Poland, Bosnia and India. Not bad for a Central European company.

## Who lost Poland?

But a gap has opened up in Central Europe. The Czechs and Hungarians have attracted top-quality foreign investment, and have capitalised on their technical skills to build knowledge-based industries. Hungary has also traded on the fact that it moved towards a market economy far earlier than its communist neighbours and, by 1988, had liberalised a far larger portion of its economy.

Yet even in Hungary the government is heading for high deficits, which could delay its entry into the single currency. The minimum wage was recently doubled, and workers outside Budapest may find themselves, in consequence, spending more time on the dole. All the area's governments know that EU aid will not be enough to balance their budgets, but at the same time know that they are too big to fail. Instead, they bide their time—in Hungary's case, by trying to nurse export-oriented national champions to health before the rules change to forbid such things.

In Poland—by far Central Europe's biggest economy—and in Slovakia, the picture is much bleaker. Unemployment is more than double the level in Hungary and the Czech Republic (see chart). Poland, once Central Europe's fastest-growing economy, grew by only 1.1% in 2001. The budget deficit looks likely to rise well above 5.0% of GDP. Part of the problem lies with the global economic slowdown, especially the recession in Germany, but much more lies in a rigid labour market and a welfare state bloated even by the standards of Western Europe.




A recent OECD report on Poland takes the government to task over labour-market reform. Payroll taxes are among the highest of any OECD country, putting even France to shame. Disability benefits, as a percentage of wages, are around 30% above the EU average. Employment protection makes sacking workers near to impossible. Such policies are a huge drag on economic growth.

Hopes that Poland's new SLD government would bring reform have been all but dashed. A dispute with the prime minister over the pace of reform cost Marek Belka, the finance minister, his job. Rafal Antczak, an economist with the Centre for Social and Economic Research, now sees three scenarios for his country. First, the current struggle between the central bank and the government could worsen, with ballooning deficits and higher interest rates. Indeed, political pressures on the ostensibly independent central bank could force its governor to resign. A Brazil-like currency crisis could follow, causing the zloty to plummet, and throwing Poland's course towards the euro into doubt. More likely, Mr Antczak says, is a long period of slow growth, of about 1-3% a year, far less than is required to converge with Western Europe's living standards. Poland could even become a permanent problem-child of the EU, and more restless young people would go on the dole.

The best, though least likely, scenario is a return to strong growth, around the 4-6% rate seen in the late 1990s. But that would require radical remedies for labour inefficiencies. According to a study by the central bank, if labour-market reforms had been put into effect in 1993, unemployment would be close to 7%, rather than the current 18%. “Poland has the welfare state of Sweden, with the corruption level of Italy,” quips Mr Antczak.

One potential source of growth, privatisation, has stalled all across Central Europe. Stroppy labour unions in Poland demand more concessions from foreign investors. The government there still maintains controlling or majority stakes in more than 3,000 companies. Giving up the reins of economic control does not come easily. All the region's governments mourn the end of the stockmarket boom and the prices once fetched by telecoms and energy companies. Some companies, however, such as national airlines and steel mills, may never be able to survive without government support. Hungary's Fidesz, an ostensibly right-wing

party, has made less progress towards privatisation in the past four years than its Socialist predecessor. The Czech Republic has done most, but it too is lagging behind schedule.

## The shadow of history

Despite the missed chances and the risks still ahead, Central Europe belongs in the EU: if not on moral grounds alone, then surely on the look and feel of the market economies it has created. The newly-built flats in Warsaw's leafy southern suburbs could almost be in Turin or Atlanta, if the skies were bluer. Shiny multi-screen cinemas, shopping centres and hypermarkets are much like those in the EU. The rivers are getting cleaner—salmon have returned to Czech rivers after a 70-year absence—and the clouds no longer seep acid rain. Central Europe's urban young are becoming as educated, cool and computer-literate as their peers in the EU. The sameness is depressing in some ways, but far better than the sullen bread queues that epitomised communism.

The EU's new Central European members will change Europe too. Redirecting at least some EU money from the continent's Atlantic and Mediterranean rim to its landlocked centre will alter not just Europe's memory of itself, but also its future look. For a start, the border of the so-called West will move east. Poland is already reinforcing its security in the primeval forests that green the border with Belarus and Ukraine, creating a new exclusionary line known, after its Eurocratic origins, as the Belgian curtain. An EU which includes Central Europe will—at any rate to begin with—be less outward-looking and more stolid.

Yet if most Central Europeans are done with the past, the past isn't done with them. Thirteen years after the fall of the Berlin wall, none of these countries has tried to confront the deeds of the *ancien régime* as, say, South Africa's Truth and Reconciliation Commission has done. Many Central Europeans feared, probably rightly, that such a confrontation might tear these fragile societies apart. Instead, a sense of “indecency”—as one Budapest economist put it—hangs over any discussion of politicians' lives before 1989. The opponents of post-communist governments, of course, are unlikely to stop talking about the past. Consider Hungary, where the prime minister, Peter Medgyessy, under pressure from the right, admitted to having been a secret-police informant. In Poland, a trial of Wojciech Jaruzelski, the former communist leader, came to naught. Expect history to make more appearances.

Fortunately, Central Europe's youthful demographics (or, more accurately, Poland's) makes it easier to shelve these questions. Poland's baby-boom of 1982—the result of the long, dark curfews of martial law—has yet to make its presence felt. These children are now coming of age; their search for jobs, and their apathy towards the history that created them, may turn out to be the country's biggest force for change. A generational upheaval on the order of 1968 remains a possibility. For their part, the young in Hungary and the Czech Republic are far too busy to be bothered with cold-war history lessons.

Admitting the new members to the EU club will not be the triumph hoped for by the generation of 1989. Indeed, rather than answering any cry for freedom, Brussels bureaucrats will be busy fending off more mundane requests for subsidies and aid. And rather than welcoming the newcomers to a booming, confident club, the EU itself is in difficulties, with some of its biggest economies—hamstrung by monetary union and the stability pact—struggling to grow themselves. The Central European members may well wonder what they have got themselves into.

On the other hand, the admission of these new countries may not be as costly as some in Paris or Berlin fear. After all, Central Europe was never as backward as the cold war and its after-effects made it seem. Though ravaged by the second world war and what followed, the region also has a history of democracy, high culture and relative prosperity. Proper reintegration with the rest of Europe, painful though it may be, is long overdue.

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The Florida gubernatorial race

# Beating about the Bush

Oct 24th 2002 | ORLANDO
From The Economist print edition

Alamy

**The race for governor of Florida is as tight as the 2000 presidential contest there**

JANET RENO, Bill Clinton's attorney-general, calls this one of the most important elections in Florida ever. Pete Deutsch, congressman for the Everglades, says it is the most important race in the country. They may both be right. The governorship of Florida will not determine the balance of power on Capitol Hill this year. But it could determine the White House in 2004.

A governorship is worth a point or two in any presidential election because of the sitting governor's local sway. Given the result in 2000, Al Gore might even be president had Bill McBride, the Democratic challenger, been in office instead of Jeb Bush. Since Florida will be one of the biggest battlegrounds of 2004, this year's governor's race will determine at least the tactics and possibly the result next time.

At any rate, the White House seems to believe it. The state, Democrats hint darkly, has received more than its fair share of federal help for local projects (Republicans claim the decisions were made on the merits). President Bush has visited the state 11 times in the campaign. It can't just be brotherly love.

So it may seem surprising that Democrats have fielded someone with no political experience. Mr McBride came from nowhere to deprive Ms Reno of the Democratic nomination. He has a decent resumé: he is a decorated Vietnam vet who turned his law firm, Holland and Knight, from a sleepy southern outfit into one of the ten largest in the country. But his real talent lies in being able to update a strange Floridian political tradition.

“Is he a *mensch*?”, shouts Joe Lieberman, Mr Gore's running mate, at a McBride rally in Fort Lauderdale. “He's a *groyse rechteche mensch*” (a great and righteous guy). This, it seems, is Yiddish for saying Mr McBride is a “he-coon”—a legendary concept in Floridian politics. At a critical moment in the final debate of the 1994 campaign, when Jeb Bush was streets ahead in the polls, Lawton Chiles, his Democratic opponent, turned to the television audience and drawled “The old he-coon always walks before the light of day.” Literal translation: “Just when you think you have a male raccoon cornered, he makes his move.” Proper translation: “I'm a real Floridian and Jeb Bush isn't.” Mr Chiles won.

Mr McBride stands in the same line of wily, down-home Florida Democratic icons. He has united the two main bits of the Democratic coalition in the state—conservative rural southerners and liberal, mostly Jewish, north-eastern retirees. Can he sneak up on Mr Bush, just as he did on Ms Reno?

Mr Bush is a tough target: he is the incumbent, he is the president's brother, he is spending twice as

much money as Mr McBride and he has proved a better debater. He has slowed the challenger's momentum, yet the latest poll still puts his lead only just ahead of the margin of error. Until recently, Mr McBride had been gaining among independent voters each week—and voters who make up their minds at the last minute traditionally go for the challenger by about two to one.

These polling swings seem to be driven mostly by voters' fluctuating feelings about Mr Bush. Jeb is the wonk of the family. He was the first governor to introduce a state-wide school voucher scheme (currently bogged down in legal wrangling). He replaced affirmative action, which gave minorities preferential places in universities, with a plan guaranteeing a state-university place to the top fifth of students in every school. Under his stewardship, Florida has weathered the recession better than most, creating more jobs in the past year than any other state.

But Mr Bush is a controversial figure. He annoyed his own supporters by vetoing more local capital projects in his first year than had been vetoed in the history of the state. The Republican leader of the Senate referred to the people around the governor as “Shi'ite Republicans”.

Tom Rossin, Mr McBride's running-mate, argues that the connecting thread of Mr Bush's difficulties is an inability to include the subjects of his reforms in the policy-making process. The governor infuriated black politicians by ignoring them when reforming affirmative action. This led to a sit-in in the governors' office. Without consulting anyone very much, Mr Bush tried to reform the child-welfare department. This blew up in his face when the department admitted it could not account for 500 children in its care.

Merle Black, a professor of southern politics at Emory University in Atlanta, points out the contrast between Jeb and his brother in Texas. George Bush made friends with the Democratic leader of the Texas legislature, wooed Hispanic voters and won overwhelming re-election. The polls suggest Jeb Bush has barely extended his base of support beyond those who voted for him in the first place. This confirms conventional wisdom: Jeb lacks George's political skills. He comes across as a know-it-all.

All the same, he is hardly to blame for the closeness of the race. That comes from the divided nature of Florida itself. Once a Republican-dominated southern state, Florida is now, as the 2000 race showed, split down the middle. It is not only the largest swing-state, but also the most partisan. In other states with close races, each of the two parties starts with only around a third of the electorate, leaving large numbers of independent voters prepared to listen to either side. In Florida, state-wide elections suggest that each party's core support now accounts for 43% of the vote.

Voters are also extraordinarily loyal. Florida brings together some of the most partisan groups in American politics. The Republican core includes the sort of cultural conservatives you find all over the south. They combine with people who have retired to the Gulf coast along Interstate 75 (see map) from the traditional Republican heartland of the mid-west. The Democratic core includes Jewish north-easterners in Miami-Dade, Broward and Palm Beach Counties along I-95. These combine with blacks, who account for about 15% of voters.

## Extracting the core

In these circumstances, the election will be decided by each side's ability to get out their voters. As elsewhere, a low turnout should help Republicans. Mr McBride's challenge is to drive up the turnout. Two things should help him.

First, the 2000 election. Many Democrats—in particular, black Democrats—think their vote was stolen in that electoral farce. They are bent on revenge. And that may mitigate a factor which, in other close states, could tip the balance towards Republicans: the president. For every undecided voter whom President Bush tempts to vote for his brother, he may also stir up at least one Democrat who is determined to make his or her vote count this time.

Second, one little-noticed element of the race may push up the Democratic turnout—and be a harbinger of national trends. That is the role of the teachers' union. In 2000, the two largest teachers' unions merged, creating a new political force in the state. This election shows the first flexing of their muscle.

The teachers put around $1.5m into the McBride campaign during the Democratic primary. His campaign manager is the union's political director. The teachers have already defeated one national political figure (Ms Reno) and are going after the president's brother. More important, the teachers have put three state-wide referenda on the November ballot. One would require the state to fund pre-school day-care. One mandates cuts in class size. And one would reform the administration of Florida's universities. In other words, says Lance deHaven Smith at Florida State University, the ballot affects parents with children from kindergarten to university. All these measures are popular—and the teachers' union backs Mr McBride.

That guarantees nothing. Because Florida has so many retirees, only about a third of voters are parents (and not all teachers are Democrats). Still, the union's anger at Mr Bush's education plans is comparable to the anger among blacks at the 2000 election. By managing the ballot in this way, teachers may well help Mr McBride.

But Mr Bush also has things to look forward to in the home straight. The more voters look at Mr McBride, the more they tend to spot that he has no track-record and that with one big exception—education—his programme is ill-defined. This gives Mr Bush the chance to paint him as a new sort of political beast—a “tax-and-cut” liberal.

Mr McBride supports the teacher's referendum to reduce class size in schools. But Mr Bush says this will cost $25 billion and argues that Mr McBride, who has repeatedly ruled out raising any taxes except a cigarette tax, is being disingenuous about paying for it. This dispute will dominate the last week of the campaign, giving a narrow advantage to Mr Bush.

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The Arkansas Senate race

# Nasty, brutish and long

Oct 24th 2002 | LITTLE ROCK
From The Economist print edition

**And probably with a Floridian aftertaste**

IN THE Mark Pryor headquarters, an old house with a balcony overlooking downtown Little Rock, red, white and blue signs lean against a wall. All have been vandalised. One of Mr Pryor's signs is spray-painted with “Daschle-lover”, a reference to his ties to Tom Daschle, the Democratic leader in the Senate. His rival, Tim Hutchinson, has also suffered. His signs have been scrawled with a black “F”, thus grading (from a Democratic viewpoint) Mr Hutchinson's performance in the Senate.

This race, pitching Arkansas's Democratic attorney-general against its incumbent senior senator, has rapidly become nasty. It hinges on what undecided voters—currently more than 10% of the total—decide to do on polling day.

When Mr Hutchinson came to office, in 1996, he was the first Republican senator to be elected in Arkansas since 1879. In Washington, he embraced family values and became a darling of the Christian Coalition—until, in 1999, he divorced his wife of 29 years to marry a former staffer 14 years his junior. But he still votes with his party 95% of the time, and a procession of senior Republicans, including George Bush himself, have come to the state to boost his re-election.

Mr Pryor hails from a local Democratic dynasty. His father, David, was governor and also occupied the Senate seat now held by Mr Hutchinson. Rob Reiner, a Hollwood director and Friend of Bill (Clinton), has given money to the Pryor campaign, though the candidate makes a habit of keeping celebrities, including Mr Clinton, at arms' length.

Both Mr Pryor and Mr Hutchinson are trying to focus on the issues—prescription-drug benefits, Medicare, the economy, the war against terrorism. But there is not always much to choose between them. Both love guns and the Bible, vital attributes for winning in Arkansas. At Halloween, Charlton “Moses” Heston, now president of the National Rifle Association, is coming to campaign for Mr Hutchinson. Yet pundits say Mr Pryor is gaining ground.

Others fear that the race could turn on Floridian factors: broken voting machines, misleading ballots and tens of thousands of voters with incorrect data in the system. This week, as a group of blacks tried to cast early votes, local Republican officials—ostensibly there to monitor voting procedures—took photographs of them and demanded their ID cards. Although no one knows how this race will end, national Democratic Party officials are already said to be booking flights to Little Rock on November 6th to challenge the result.

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**Washington's sniper**

# A breakthrough at last?

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From The Economist print edition

Reuters

**After another grisly week, two important arrests**

IN THE first week, people were nervous. In the second, they became frightened. In the third, the public mood has moved close to hysteria. Yet the search for the Washington-area sniper finally seems to have made progress. As *The Economist* went to press, the police were interviewing two men—apparently John Allen Muhammad, an ex-serviceman, and his stepson—in connection with the case.

The two men were arrested early in the morning of October 24th in Maryland. Mr Muhammad, who was previously known as Williams, faces charges for violating federal firearms laws. A house in Tacoma, in Washington state, has been searched—and a tree stump that had been allegedly used for target practice taken away. There is also a possible connection to a shooting in Alabama in September.

This seemed an uplifting end to a depressing week that had raised more questions about the police handling of the case. It began with the killer returning after a four-day lull and severely wounding a motorist on October 19th. By October 22nd, he had returned to southern Maryland (where his spree began) to kill a bus driver standing inside his vehicle, doing paperwork. In all, the sniper has now killed ten people and wounded three; for the 4m-plus people in the area, venturing outside has been a terrifying prospect.

Especially as the sniper's story had got stranger. The man believed to be the killer had stepped up his contacts with police. He started with a tarot card inscribed “Dear Mr Policeman, I am God”, which was found near the scene of the shooting of October 7th. In a subsequent letter, found near the October 19th shooting site, he apparently repeated his claims to divinity, asked for $10m and, most alarmingly, warned parents that “your children are not safe anywhere at any time”.

The police called news conferences to deliver cryptic messages to the killer. The most recent, which came at the same time as the announcement of the manhunt for Mr Muhammad, was “You want us to say: ‘We have caught the sniper like a duck in a noose.’” They also talked to the sniper on the telephone. He had to ring the investigation hotline several times before he got through; once, a trainee federal officer cut him off.

Street-level officers have complained that they have not had enough information. On October 21st local police in Virginia unilaterally decided to ambush two men in a white van who were using a service station payphone. The incident briefly raised hope that the killer had been caught; but the unlucky detainees were guilty of nothing worse than expired visas, and will soon be deported. Mr Muhammad's car was spotted because details about it were leaked to the press; the police, weirdly, had wanted to keep it secret.

Some think the FBI should have taken over the inquiry, which involves umpteen different forces. It has been led by Montgomery County's police chief, Charles Moose (who does not appear to be relishing his 15 minutes of fame). But local authorities remain best-placed to charge the sniper—whoever he is. There is no federal murder statute.

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**Politics in Colorado**

# Drama in the Rocky Mountains

Oct 24th 2002 | BOULDER AND COLORADO SPRINGS
From The Economist print edition

**The Republicans cannot take Colorado for granted**

IT OFTEN seems hard to imagine the Republicans losing anything in Colorado. It was one of the states to back Bob Dole over Bill Clinton, and George Bush carried it by nine points. Around Colorado Springs there are more Libertarian than Democratic candidates in the local elections. Governor Bill Owens looks set to clobber his Democratic opponent, Rollie Heath, by a huge margin, already prompting talk in Republican circles that the impressive young conservative might make a fine successor to Mr Bush.

So what is the problem with Senator Wayne Allard? The incumbent is running neck-and-neck in the polls with his Democratic challenger, Tom Strickland. Both national parties have already pumped millions of dollars into the increasingly ferocious campaign.

Last time the two men faced off, in the 1996 Senate race, Mr Allard, a seasoned Colorado politician, won comfortably. The senator is widely seen as a dependable sort who has never lost an election in his 20 years in politics. He has fulfilled his campaign pledge to hold town meetings in all Colorado's 64 counties. In political terms, he has a solid conservative record, though with a few rather human wrinkles. A veterinarian by training, he sponsored a ban on interstate commerce in fighting birds. Ever the gentleman, he also helped confirm Mr Strickland as a US attorney.

All very diligent and courteous; but such things have not always grabbed the headlines. Part of Mr Allard's problem is that he is not perceived to be pushy enough. That charge is unlikely to be levelled at Mr Strickland, a former offensive-lineman for Louisiana State ("I can take a blow. I can deliver one," he says). A more prickly character, Mr Strickland has worked assiduously to build up his profile since the last race. He also claims that his views are closer to the centre of Colorado politics: he is a fiscal conservative who supports choice on abortion and makes much of his keenness to protect Social Security from privatisation.

In this respect, at least, Mr Strickland may have a point: Colorado is not as conservative as it is often cracked up to be. Conservative, religious Colorado Springs must be set against liberal Boulder. The Democrats currently control the state Senate (though largely because of Republican infighting). Despite Mr Owens current popularity, he won the governorship in 1998 by a mere 8,000 votes over Gail Schoettler, a moderate Democrat.

Senior local Republicans worry about losing two sorts of voters: college-educated women (particularly in the suburbs of Denver) who are nervous about any signs of intolerance from the religious right; and the small but growing number of Latinos, who react adversely to any Republican hostility on immigration. From this perspective, the recent decision of Tom Tancredo, a Republican congressman from the Denver suburbs, to turn in a Mexican honours student to face immigration charges was, argues one Republican bigwig, "extremely unhelpful".

This sounds close to what happened to the Republicans in California (see article). Half a million voters, many of them from California, have moved here since Mr Allard's last race, mainly to the burgeoning suburban strip that runs north and south along the Front Range of the Rockies. Most are well-educated, white-collar people, who are not affiliated to either of the main parties and are worried about the economy: unemployment in Colorado has doubled since the end of 1999.

Most people would still bet on Mr Allard just sneaking home. For all Mr Strickland's assaults, he hardly fits the caricature of an arch-conservative. He has also managed to land some blows, pointing to Mr Strickland's career as a "lawyer-lobbyist" for big companies. But Colorado is also home to some fierce House races—notably in a competitive new district in the northern suburbs of Denver. Governor Owens's

future may soon drift towards Washington, DC; but his party is learning the hard way that it cannot take Colorado for granted.

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The economy

# After the vote, what then?

Oct 24th 2002 | WASHINGTON, DC
From The Economist print edition

**The mid-term elections might change economic policy dramatically**

IN THESE last days before the mid-terms, Washington is blissfully free of politicians. Lawmakers are back home fighting for their seats, or stumping for others. George Bush has decamped to Texas and a nearly non-stop campaign tour. But while the protagonists have gone, Washington's hordes of lobbyists and policy wonks are consumed with speculation—not just about what will happen on November 5th, but what the outcome of the mid-terms means for economic policy.

The most detailed fiscal blueprints have come from several leading Democrats—all still convinced that the flagging economy is the Republicans' weak flank. Dick Gephardt, the future Speaker of the House of Representatives if the Democrats recapture control, laid out a “New Economic Agenda for a New House” last week. His $200 billion package included a one-off tax rebate for poorer Americans, a higher minimum wage and more money for schools, anti-terrorist infrastructure and health. Joe Lieberman, a leading senator and presidential hopeful, set out an “Agenda for Economic Prosperity” that includes tax credits for firms that buy computers or hire new workers over the next year, and a tax rebate for poorer people.

Despite their detail, these blueprints are more about politics than policy. The Democrats do not have a united front on matters economic. And even sympathetic economists play down many of the stimulus ideas. Peter Orszag, a former Clinton economic adviser currently at the Brookings Institution, points out that the most useful Democratic ideas (such as extending unemployment insurance, which, for many people, runs out on December 28th) are not politically sexy. So politicians lard their plans with politically appealing but economically dubious ideas, such as raising the minimum wage.

To add to the air of unreality, even if the Democrats kept control of the Senate and won back the House, Mr Bush would still be president. Gridlock, rather than a Democratic agenda, would be the outcome.

That of course would not apply if the Republicans were to win back the Senate, giving them control of Congress as well as the presidency. One Republican think-tanker told the *Washington Post* that the mood among business lobbyists and economic conservatives was “bordering on giddiness”, adding “It's like the domestic equivalent of planning for post-war Iraq”.

Democrats, too, worry that this could be a turning point. Robert Reischauer, head of the Urban Institute and a prominent Washington budget expert, reckons these mid-terms could “potentially be the most important congressional election since 1964”, when a huge Democratic majority in the House of Representatives, as well as control of the Senate, allowed Lyndon Johnson to push through dramatic social policies. For Mr Reischauer, the risk today is an equally large lurch to the right: a bevy of conservative judges, Republican-oriented Medicare reform, tighter work requirements for welfare and a plethora of budget-busting tax cuts.

How plausible is this? In some areas, such as breaking the log-jam over judicial appointments, Republican control of the Senate would make a huge difference. But in other areas, especially tax policy, the scope of Republican plans is unclear. Although the Bush administration contains many economists who want dramatic reform of America's tax code, there are no detailed fiscal blueprints. Paul O'Neill, the treasury secretary, has promised to put forward a bold plan for tax reform soon; others want fundamental reform to be part of a second Bush term.

In the short term, the main fiscal focus will be on making the 2001 tax cut permanent (technically, these tax cuts expire at the end of 2010). If the economy continues to look weak and the stock market lacklustre, investor-friendly tax cuts, such as increasing the amount of investment losses an investor can

deduct from his taxes or raising the amount of money that can be put in tax-friendly retirement accounts, are likely to be on the agenda.

Many in the administration want to cut (or, ideally, eliminate) the double taxation of dividends. On the other hand, Mr Bush would have to cope with ever-larger budget deficits. And he does not want to be seen to be rewarding only rich investors. Most insiders reckon that Mr Bush will choose a smattering of different tax cuts rather than a single bold proposal.

Moreover, any Republican majorities in Congress are likely to be small, thereby limiting room for dramatic changes. The risk of filibuster means that most laws will need 60 votes to pass the Senate. Mark Bloomfield, a lobbyist for lower taxes on capital, sees “no earthquake” on Capitol Hill after November 5th. He reckons it will be hard for Republicans to find the votes to speed up and make permanent the Bush tax cut, let alone pass new ones. Many of the proposed tax cuts, such as reducing the double taxation on dividends, have no corporate constituencies lobbying for them. And business leaders in the post-Enron world are too worried about their companies to mount a big lobbying effort for radical tax reform.

So the chances of radical tax reform in the short-term may be slight, but tax cuts of some sort still seem eminently plausible. If the Republicans can keep their discipline and attract a few Democrats who like lower taxes, they should be able to push through an overall budget resolution, which would protect tax cuts from filibuster. If the Republicans retake the Senate, it may not be the domestic equivalent of post-war Iraq, but it certainly would not be business as usual.

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The New Hampshire Senate race

# Natural-born Republicans

Oct 24th 2002 | DURHAM
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**But with a few nerve-wracking twists**

AP

**Goody Two-shoes, I presume?**

NEW Hampshire has an ambivalent relationship with the Bush dynasty. This rural enclave was the only state in New England to vote for George Bush in the 2000 presidential election, giving him four vital electoral votes. But its presidential primary has seldom been kind to the Bushes. In 1992 George Bush senior beat Pat Buchanan by an insultingly small margin for a sitting president; this was to be a warning of disaster to come. In 2000 his son lost to John McCain, igniting an internal Republican revolt that was only stopped by dark deeds in South Carolina.

Now the state has a chance to determine whether President Bush can push his ambitious legislative agenda through Congress. Republicans will be hard-pressed to win control of the Senate if they allow their hold over New Hampshire to be broken. But Jeanne Shaheen, the Democratic candidate, is putting up a strong fight against her Republican rival, John Sununu, and stands an even chance of becoming the first Granite State Democrat elected to the Senate since 1975.

New Hampshire has 245,791 registered Republicans, compared with 242,028 independents and just 170,405 Democrats. The culture of the state, from its motto (“Live free or die”) to its laisser-faire attitude to adults wearing seat-belts, is thoroughly Republican. The state has one of the lowest tax burdens in the country and no income tax. Republicans control both statehouses and both congressional seats.

The easiest way to get applause in a political meeting is to make a joke about Teddy Kennedy, a man who combines the sins of being a big-government liberal with the even worse sin of coming from Massachussets. It's not for nothing that two of America's most amusing conservative writers, Mark Steyn and P. J. O'Rourke, have houses in New Hampshire.

The Republican establishment also succeeded in engineering a coup during its primary, getting rid of their embarassing incumbent, Bob Smith. Mr Smith had alienated Republicans, both locally and nationally, by leaving the party in a sulk when his bid for the presidency went nowhere, denouncing the Republicans on the Senate floor, and then rejoining them in return for a committee chairmanship. Internal party polls also showed that Mr Smith was likely to lose to Ms Shaheen.

Mr Sununu is a much sounder candidate than his predecessor: a three-term congressman whose father was the state's governor before becoming Bush senior's chief-of-staff. He makes up for his Vulcan-like manner with a willingness to stand up for his principles and a wry sense of humour. He will also get a filip from Craig Benson, a software millionaire, who is boosting the Republican cause by spending over $10m on the governor's race.

Yet Mr Sununu is struggling to capitalise on this natural advantage. A month ago, the polls put him ahead of Ms Shaheen by as much as ten points. Now the lead seems to be alternating, though the latest poll, from the American Research Group, puts Mr Sununu ahead by eight points.

Mr Sununu faces two big problems. The first is the bitter legacy of the Republican primary. A significant number of Mr Smith's supporters plan to take revenge by staying at home, writing in Mr Smith's name, or even voting for Ms Shaheen. Conservatives complain that, thanks to the establishment's double-dealing, the number of “movement” conservatives in the congressional delegation has shrunk from three

in 1993 to none today. Buchananites sneer at Mr Sununu's father. Meanwhile some moderates worry that Mr Sununu is not as green as Mr Smith.

The impact of all this is not clear. A poll earlier this month by the survey centre at the University of New Hampshire found that one in four Republicans who voted in the primary would vote for Ms Shaheen. Some analysts speculate that 2-3% of Republicans may write in Mr Smith's name. The closeness of the election and the size of the stakes in Washington will probably reduce both these numbers. But the party's internal squabbles have undoubtedly diverted energy and resources. So far, Ms Shaheen has spent over $5m on the race—about $2m more than Mr Sununu.

The second problem is Ms Shaheen herself. The three-term governor is a dream candidate for the Democrats: a moderate who supports Mr Bush on tax cuts and Iraq but nevertheless endorses a slew of Democratic spending projects. Ms Shaheen is one of life's head-girls; her fixed smile and Goody-Two-shoes manner give her an uncanny resemblance to the anti-hero of “Election”, a film about an insufferable girl who will do anything to become senior class president. But she is making a good job of reaching out to the state's vital independents, painting Mr Sununu as a right-wing ogre and emphasising her friendship with Jim Jeffords, the only independent in the Senate.

The closeness of the race means that New Hampshire is saturated with politics. Radio programmes are interrupted every few minutes by political advertisements. Every lawn has sprouted a sign. The two campaigns will probably end up spending $15m on the Senate race—an astonishing figure, when you consider that only 300,000 people will turn out to vote.

Whoever wins on November 5th, Arab-Americans will have something to celebrate. Mr Sununu is part-Palestinian and part-Lebanese. Jeanne Shaheen is married to a Lebanese-American. New Hampshire, a state which is often criticised for forcing America's primary candidates to parade before an all-white audience, is about to do its bit for the fortunes of one of America's most overlooked ethnic minorities.

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Lexington

# Oh, California

Oct 24th 2002
From The Economist print edition

**The Golden State has become a one-party haven. It's not a pretty sight**

ACROSS America, political power rests on a knife-edge. A slight slip could switch control of the Senate, or of the House, or of numerous governors' mansions. The result of this gridlock, Americans are so often told, is politics of the basest sort. Caution and defensive negativity are the order of the day. Big issues go unaddressed while political troops snipe at each other in gruelling trench warfare. Political life in a “50-50 nation” regresses to a tenacious battle of primitive loyalties.

Could politics be any worse? Well, for one in eight Americans, it is. California, the richest, most populous, most dynamic state in the country, definitely does not have 50-50 politics. Its public life lacks even the semblance of balance—and it stinks.

California's Democratic governor, Gray Davis, is cruising towards re-election with a ten-point lead, according to the latest poll. Both senators (neither of whom is up for re-election this time) are Democrats, as is the bulk of the congressional delegation. Thanks to gerrymandering by the Democrats, the entire state can muster only one competitive congressional seat—the one currently occupied by Gary Condit, a disgraced Democrat who is retiring. State government is equally one-sided: the Democrats have comfortable majorities in both houses. Just one statewide office is held by a Republican.

And the result of this marvellous consensus and unanimity? It is hard to think of any piece of legislation that Mr Davis will be remembered for, other than a muddled attempt to solve the electricity crisis. There has been little reform at the state's dreadful schools and none at its hospitals; transport is worse than ever and voters are seething at the possibility that their water, like their power, may one day dry up. Enthusiasm for politics is even lower than it is in the rest of the country. The only flurries of interest come when laws are forced on the politicians through ballot initiatives raised by frustrated interest groups.

The absence of political tension has also limited outside interest in the state. To be fair, George Bush's campaign did lob $13m worth of advertising into California in a last-minute salvo in 2000; but Al Gore still carried the state by 12 points, and Mr Bush's administration has paid little heed to California's wishes since then. He did not support Bill Simon, Mr Davis's opponent in the Republican primary—and has kept his distance since.

The domination of California by Democrats is not a reward for their own talent. It is the result of the collapse of the state's Republicans. Mr Davis is as unpopular as a governor has ever been. His poll numbers have stuck around their current 41% for months, and as many as one in five Californians have still not decided whom to vote for. This gives the Simon campaign a fragment of hope (one apparently rogue poll showed him only three points behind). But even if the race narrows, it ignores the point: with an energy crisis, a horrendous budget deficit and a reputation for mixing money-raising with law-making, Mr Davis should surely be the one desperately trying to catch up.

His relative comfort stems from a pre-emptive defence by his Machiavellian campaign manager, Gary South. The Democrats spent $10m during the Republican primary attacking Mr Bush's choice, Richard Riordan, a former mayor of Los Angeles, for supporting abortion; the Republican die-hards duly voted for Mr Simon, a political novice who is against abortion. But even this scam, on reflection, seems more a testament to the California Republicans' boneheadedness than Democratic cunning. When Jeb Bush

intervened on behalf of Janet Reno in the Florida primary, trying to oust the more electable Bill McBride, those legendarily intelligent Democrats (remember the old ladies who voted for Pat Buchanan by mistake in 2000?) saw the ruse a mile off and picked Mr McBride.

At any rate, Mr Simon cannot have disappointed Mr South. A first attempt to get his campaign airborne crashed when a jury found his family firm guilty of fraud. That judgment has been reversed, but now Mr Simon has made a slight fool of himself in a debate with Mr Davis, brandishing what he claimed were photographs of the governor illegally soliciting campaign contributions in his office. It turned out that the photographs had been taken in a private house.

The problems go much deeper than Mr Simon, a worthy sort who simply seems to have been promoted beyond his political abilities. The recent state Republican convention in Anaheim showed how little the California party has learned about Mr Bush's compassionate conservatism. Barely bothering to go through the motions of appealing to minorities, the roster featured a series of middle-aged white men. Meanwhile, at the back of the hall, a talented young black assembly candidate from south Los Angeles complained that he had got no help from the party. In Texas, he would have been on the podium.

## Bring on the Terminator in 2006

And the consequences of more one-party rule? Mr Davis's “pay-to-play” system will continue to operate, with the governor raising money by promoting himself to businesspeople as a necessary bulwark against the regulating radicals in his own party. Mr Davis, who should never be underestimated, may use the cash to have a crack at the presidency. The big hope for the state focuses on the 2006 race, when Mr Davis is term-limited and when a new campaign-finance law he has just signed kicks in, making it much harder to raise money from outsiders.

Two Democrats, the state attorney-general and the treasurer, both hope to carry forward funds from easy re-elections this year. Meanwhile, Arnold Schwarzenegger is edging back into contention for the Republicans—his attributes being not just his muscles but also his money. In the future, thanks to the new fund-raising law, Californian politics may become the exclusive domain of the very rich—which may be a better thing than being the exclusive domain of one party.

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Ecuador's election

# New faces of Andean politics

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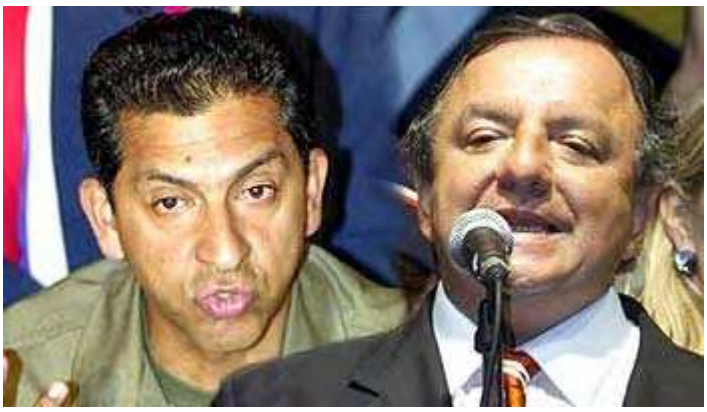
From The Economist print edition

AP/Reuters



**Neither Lucio Gutierrez, a leftist colonel, nor Alvaro Noboa, a banana magnate, looks likely to bring stability to Ecuador, but both embody new regional trends**

Get article background

IMAGINE having to choose between Venezuela's Hugo Chavez and Italy's Silvio Berlusconi for president. That resembles the unenviable decision Ecuador's voters have given themselves in a run-off ballot for their country's presidency in a month's time. In the election's first round on October 20th, the voters favoured two outsiders. The surprise winner with 20.4% of the vote was Lucio Gutierrez, who as an army colonel led a coup which toppled an elected president in 2000. He will face Alvaro Noboa, Ecuador's banana king and richest businessman, who won 17.4%.

Ecuador has never been famous for economic or political stability. Even so, its election seemed to confirm some recent trends in South American politics, and especially those of the Andean countries. They include dissatisfaction with traditional leaders, political fragmentation, a shift in some places to the left, the growing political influence of Indian groups—and the likelihood that change will be less radical than the more lurid headlines suggest.

Mr Gutierrez, a leftist nationalist, was briefly jailed after leading a coup backed by Ecuador's powerful Andean Indian movement, which saw the overthrow of President Jamil Mahuad in January 2000. He is supported by far-left groups, a network of lower-ranking military officers and their families, and Pachakutik, the party of the indigenous movement.

In the past, Mr Gutierrez has expressed admiration for Mr Chavez, Venezuela's incompetent populist ruler. Like Mr Chavez, he has centred his campaign on fighting corruption. And like Mr Chavez, he has campaigned in a green military-style uniform. But unlike Mr Chavez, Mr Gutierrez was an outstanding soldier, is quiet and serious, and is moving swiftly to the centre. He now talks of negotiating with the IMF, attracting foreign investment and encouraging more competition, though somewhat contradictorily he also wants price controls for basic goods and services. And he says he will switch to civilian clothes.

## Big banana skins

His opponent could hardly be more different. Mr Noboa inherited a business empire based on bananas, but including shipping, manufacturing and an airline. He lost the presidency to Mr Mahuad in 1998. Mr Noboa has campaigned as a populist, staging charitable giveaways and promising jobs and houses. On

policy, he is even vaguer than Mr Gutierrez. He claims to be market-friendly. He promises not to increase utility charges or taxes. Having led the polls, his support slipped after his flourmills raised their prices. That reflected a rise in the world wheat price, but clashed with his promise to help the poor—and highlighted the many conflicts of interest he would face as president.

The run-off is likely to be close. As is traditional in Ecuador, it will partly be a regional battle. Mr Noboa is from Guayaquil, a coastal port and the largest city, while Mr Gutierrez's support is centred on the Andean highlands and Quito, the capital.

Favouring Mr Gutierrez is an understandable desire for change. In 1999, Ecuador descended into economic chaos: Mr Mahuad defaulted on the foreign debt, much of the banking system collapsed, and hyperinflation beckoned. Since then, under Gustavo Noboa (no relation to the candidate), Mr Mahuad's vice-president, Ecuador has found a precarious economic stability by adopting the dollar as its currency. Higher oil prices have brought modest economic growth. But more than half the population are officially poor.

Making dollarisation work requires structural reform, something President Noboa has failed to achieve. Ecuador's businesses are struggling against high costs. The public finances face a shortfall. A new agreement with the IMF has proved elusive. Neither candidate says he would scrap the dollar, but neither says much about reform. The winner will face extra difficulties. In voting for Congress, the discredited traditional parties clung on. Neither presidential hopeful will command more than a fifth of the seats in the legislature, and will have to bargain for support.

If Mr Gutierrez wins, he will lack the kind of support Mr Chavez enjoyed at the outset of his “Bolivarian revolution”. Rather, he will be greeted by the kind of tricky task of democratic reform that seemingly faces Brazil's Lula (see article). Whichever man wins, his first challenge will be to do better than Ecuador's past two elected presidents, neither of whom survived longer than 18 months into their four-year term.

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Politics in Venezuela

# No way out?

Oct 24th 2002 | CARACAS
From The Economist print edition

### A military protest and a frustrated opposition

Get article background

SINCE a failed coup attempt last April against President Hugo Chavez, it has not always been easy to have sympathy for Venezuela's squabbling opposition—and the outside world has shown little. Yet the opposition argues that it is in a genuine bind: if it tries to play by constitutional rules, the government reacts by moving the goalposts. But if it responds to Mr Chavez's violations of his own charter by invoking the constitutional right to rebellion, this is condemned, at home and abroad, as coup-mongering.

AP

**Far from quiet on the Caracas front**

This week, two things combined to put the opposition's dilemma into sharp focus. First, the government squashed a plan for a referendum on Mr Chavez's rule. Then, a group of dissident military officers began an unusual protest in a Caracas square to try to force the president out.

For the opposition, which includes business, trade unions, the media, the church, and a host of political factions, Mr Chavez is an elected autocrat who is leading Venezuela to economic ruin and undermining its democracy. Its current offensive against the president began with a huge march (of perhaps 1m) on October 10th. But Mr Chavez, who claims to be leading a “Bolivarian” revolution on behalf of the poor, responded with his own (almost as large) march. He mocks his opponents as weak and divided.

He has a point. The opposition lacked the strength to sustain a national strike against Mr Chavez called by private business and the main trade-union confederation on October 21st, the third such stoppage within a year. But as the strike ended, the Democratic Co-ordinator, the opposition umbrella group, launched a plan to spend the next fortnight gathering the 1.2m signatures required by law to hold a referendum on Mr Chavez's rule.

Under the constitution, drawn up by Mr Chavez's allies in 1999, such a referendum would not be binding. For that, the opposition must wait until August, 2003 (the halfway point of the president's current term), and gather twice as many signatures. But the opposition's gamble is that the president could not hang on if his claim to represent the majority were exposed as false.

This plan had the merit of offering a peaceful resolution of Venezuela's potentially explosive political confrontation. But hardline opponents of Mr Chavez fretted that the president would simply procrastinate over any referendum; they want an indefinite strike to force him out. That view seemed partially

vindicated when the National Assembly, where Mr Chavez retains a narrow majority, refused to debate the referendum proposal, arguing that it was “illegal”. Meanwhile, the head of the electoral authority declared that he lacked the money to hold a consultative referendum (though that didn't stop Mr Chavez organising three of them).

The hardliners then suddenly launched their own plan. On October 22nd, a group of 14 dissident generals and admirals, many accused of backing April's coup, declared themselves in “legitimate rebellion” against Mr Chavez, and set up camp in Plaza Altamira, a square in a leafy Caracas district. Calling for civil disobedience to force the president's resignation, they were joined by dozens of more junior officers and by several thousand civilians. The officers invoked Mr Chavez's own, 1999 constitution, which enshrines the right to rebel against any regime that “contradicts democratic values, principles and guarantees, or limits human rights”.

Their move puts the civilian opposition in a tight spot. The Democratic Co-ordinator blamed the government for the military discontent, but rejected “any solution that involves a coup”. The government dismissed the officers as “coup-mongers” who would be court-martialled. The Organisation of American States, which has been seeking to mediate, said their pronouncement violated the body's Democratic Charter, approved last year.

Any hopes the protesters had that army units would join in were not immediately fulfilled. Many of the dissidents were removed from troop commands by Mr Chavez, but remain on active service. As *The Economist* went to press, the generals and admirals were still in the square, and so were the crowds supporting them. The government was still insisting that everything was “normal”. By Venezuelan standards, perhaps it was.

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**Brazil's presidential election**

# Talking victory

Oct 24th 2002 | SAO PAULO
From The Economist print edition

## Lula's plans for government by jaw-jaw

Reuters

Get article background

**Lullabies with Lula**

BARRING a last-minute accident, Luiz Inacio Lula da Silva of the left-wing Workers' Party (PT) seems assured of a sweeping victory in the run-off ballot for Brazil's presidency on October 27th. The opinion polls give Mr da Silva a steady lead of some 30 percentage points over Jose Serra, the candidate of President Fernando Henrique Cardoso's centre-right coalition. In three weeks of campaigning since the election's first round (in which Lula won 46.4%), Mr Serra has focused his attack on his opponent's spending promises. Failure to fulfil them would amount to “electoral fraud”, but doing so would ruin the country, said Mr Serra. Voters seemed impervious—but investors are not.

The *real* and Brazil's bonds have plummeted as the certainty of Mr da Silva's victory has grown. This week they rallied after a spokesman said that Lula would further tighten Brazil's fiscal policy, if that was needed to stabilise government debt. But what investors most want to know is who would run the economy. They may not get a swift answer. Mr da Silva says only that after the vote he will announce a “transition team”, whose members will not necessarily become ministers.

That is because Mr da Silva would face constraints in choosing his cabinet. Though the PT has become the biggest party in Congress's lower house, it still has only 92 of the 513 seats. Assembling a governing coalition would mean letting other parties nominate some ministers. To avoid internal dissent, some jobs would have to be offered to the PT's unreformed left, which has 26 of its lower-house seats.

Mr Cardoso has found it hard to pass urgent but unpopular reforms. Mr da Silva's promises are more ambitious: they include streamlining the byzantine and growth-stifling tax system, resolving the perennial conflict between landless peasants and rural landowners, and doubling the real value of the minimum wage. But his alliance would probably be smaller but more diverse than Mr Cardoso's.

Mr da Silva's answer is to sit everyone around the table in a grand “national dialogue”. He will seek partnerships with everyone: governors, mayors, bosses, unions, charities. All sorts of talking-shops will be created, of which the most important will be a Council of Economic and Social Development attached to the presidency. Based on France's Conseil Economique et Social, this will tackle poverty, while a separate National Council of Regional Policies will combat regional inequality. New transport committees, involving federal and local government, will fix the roads and railways.

Mr da Silva argues, with some justification, that Mr Cardoso failed to mobilise Brazil's political forces sufficiently, pointing out that in his eight years in power he held only two meetings with the 27 state governors. But nor is it wise to make everything negotiable: Lula might come to regret an offer to talk to governors about another financial bailout—something that Mr Cardoso's fiscal-responsibility law supposedly banished. Many of the grandly-titled forums may simply become irrelevant. But they risk wasting the crucial early months of the presidential term in hot air.

The public finances require swift action. So does Brazil's worsening criminal violence. This week, a gang in Sao Paulo was caught apparently about to plant a car bomb at the city's stock exchange, while Rio's drugs gangs continue to terrorise schools and businesses. Rather than a grand national pact, the voters

may soon yearn for decisive action.

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Colombia's conflicts

# The fight for the cities

Oct 24th 2002 | BOGOTA
From The Economist print edition

## Uribe faces a new front

Get article background

UNTIL recently, Colombia's cities, where most of its 44m people live, were relatively unscathed by decades of war between left-wing guerrillas, right-wing paramilitary vigilantes and the armed forces. That now seems to be changing. Last week, in two days of fierce combat, troops retook Comuna 13, a guerrilla-held suburb of Medellin, Colombia's second city. In what looked like retaliation by the FARC, the largest guerrilla force, on October 22nd a car bomb exploded outside the main police station in Bogota, the capital, killing two and injuring 36.

A sprawling warren of self-built brick houses high on Medellin's western flanks, Comuna 13 has been the site of bloody combat between guerrilla and paramilitary factions, with 373 killings there between January and August. The government had barely responded—until last week. In an operation ordered by Alvaro Uribe, Colombia's new president, 1,000 troops, backed by helicopters, fought their way in, block-by-block. At least 14 soldiers, guerrillas and civilians were killed, and 45 rebels were arrested. That still leaves the paramilitaries, who claim to control 70% of Medellin. The government says it will move against them, too. But Mr Uribe, who is from Medellin, also authorised the city's mayor to begin local peace talks.

So is fighting on the streets the shape of things to come in Colombia? Not necessarily. Medellin is especially vulnerable to rebel groups, partly because of years of government neglect, but mainly because both sides have been able to co-opt the city's hundreds of murderous gangs, previously linked to drug mafias. Other cities have less violent histories.

Nevertheless, guerrillas and paramilitaries both aim to expand in urban areas, says Leon Valencia, a former member of the ELN, the second guerrilla group, and now a political analyst. In the past, the guerrillas sought support in trade unions and peasant organisations. Now, the FARC, corrupted by drug-trafficking and kidnapping, is targetting marginal, deprived and crime-ridden neighbourhoods.

The cities provide the guerrillas with supplies and recruits, and a venue for headline-grabbing attacks against the state by “special forces”, says Mr Valencia. Such actions include a FARC mortar attack on the day of Mr Uribe's inauguration in August, and its kidnapping of a dozen regional councillors in Cali, the third city, in April. The paramilitaries, for their part, entered Medellin in search of their foes, and looking for a political base. Last year, for similar reasons, they took control of Barrancabermeja, an oil city, after months of block-by-block combat with guerrillas.

Despite the recent attacks, Bogota is not at great risk, insists Martha Lucia Ramirez, the defence minister. Compared with Medellin, the capital is calm: its murder rate has more than halved since 1993. The guerrillas and the paramilitaries have a presence in the city, admits Hugo Acero, the city council's chief of security policy. But he says Bogota is free of no-go neighbourhoods; its mayors have invested heavily in services in poorer areas.

But the FARC is not far away. Despite the army's efforts, it retains a base at Sumapaz, a mountainous massif to the south that lies within the capital's administrative boundary. Next door lies Soacha, a grim,

depressed town bloated by thousands of refugee families displaced by violence. Some of its suburbs harbour small paramilitary and guerrilla militias. Soacha is “a time bomb”, says Maria Eugenia Suarez, who edits a community newspaper there. Mr Acero wants help from Mr Uribe to improve security in Soacha and Sumapaz.

The president seems to be taking the urban threat seriously. This week, 1,500 soldiers stormed into several Cali shantytowns, arresting 38 people. Bogota is to get a new 212-strong anti-terrorism police squad, and more than 30 new police posts in outlying suburbs. In November, 1,000 extra police will bring the city's total force to 11,300—though that is still small for a place of around 6.7m people.

According to Mr Valencia, the most vulnerable city may be Cucuta, the sixth-largest, with 700,000 people. Close to the border with Venezuela, it is well-sited for smuggling arms and supplies. It is being targeted by rebels from both sides. Their battles are largely behind a rise in Cucuta's murder rate of 87% in the first half of the year. Medellin's Comuna 13 may not be the rule in Colombia—but neither is it wholly exceptional.

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North Korea's nuclear programme

# Getting the genie back into the bottle

Oct 24th 2002 | BEIJING AND WASHINGTON, DC
From The Economist print edition

**America, China, Japan and South Korea all need to work together to persuade North Korea to scrap its nuclear weapons programme**

Get article background

IN A series of meetings with Asian leaders at the end of this week, George Bush will be trying to prevent a new security crisis from emerging on the Korean peninsula, following North Korea's admission that, in defiance of its promises, it has been secretly enriching uranium that can be used to make nuclear weapons. China's President Jiang Zemin, now on his farewell visit to America as head of state, will be a crucial interlocutor. But Mr Bush may find it hard to persuade him that the North's misbehaviour is as worrying as it looks.

Mr Bush's summitry begins on Friday at his ranch in Crawford, Texas, where he is due to have a barbecue lunch (a highly-prized honour, according to the official Chinese media) with Mr Jiang, followed by an hour or so of discussions accompanied only by interpreters. On the following day, the two leaders will join 18 others in Cabo San Lucas, Mexico, at an annual meeting of the Asia Pacific Economic Co-operation forum. In the margins of this gathering, Mr Bush was also due to meet Japan's prime minister, Junichiro Koizumi, South Korea's president, Kim Dae-jung, and Russian officials—all of whose support he needs in his efforts to resolve the North Korean problem without complicating his strategy for dealing with Iraq.

The importance America attaches to China's role was evident in the decision to make Beijing the first port of call when two senior State Department officials set off last week to consult other countries about the North Korean nuclear issue. China is probably the biggest supplier of aid to North Korea and describes itself as a close friend, despite a few recent spats.

The Chinese are now irritated with North Korea for having complicated what was supposed to be a friendly farewell visit by Mr Jiang to America before his semi-retirement next month. The last thing Mr Jiang wanted was a trip overshadowed by accusations that Chinese technology may have helped the North Korean programme (even though most of the equipment is thought to have come from Pakistan). In an effort to prove they are no longer part of the proliferation problem, China has issued a series of regulations since August tightening restrictions on the export of technologies that could help make weapons of mass destruction.

China, said its foreign ministry spokesman this week, “consistently supports the denuclearisation of the Korean peninsula.” Still, Chinese officials appear less concerned than the Americans are about the possibility that North Korea's nuclear programme could have produced a deliverable nuclear weapon. As the Chinese see it, the real threat emanating from North Korea is a political collapse that could damage stability in the region and prompt American forces to move close to China's border to fill the vacuum. Should Mr Bush call for economic pressure on North Korea, he is unlikely to find China receptive.

Some experts believe that by admitting to having a uranium programme, North Korea may be trying to engage a stand-offish America rather than threatening it. “North Korea is not in a position to threaten the United States. It's also not in a mood to do so,” says Jia Qingguo of Beijing University, who sees the confession as an act of contrition similar to its admission to Mr Koizumi in September that North Korea had abducted Japanese citizens.

Certainly China seems unprepared to condemn its old friend openly for undermining an accord reached in 1994 between the United States and North Korea. This pact, known as the Framework Agreement, required North Korea to abandon its graphite-moderated nuclear reactor programme, based at Yongbyon. A by-product of this type of reactor is plutonium which, like enriched uranium, can be used to make nuclear weapons. In exchange, an American-led consortium would help the North Koreans build two light-water reactors, whose waste is more difficult (though not impossible) to convert into weapons-grade material. Work on the first of these began in August at Kumho.

The Americans appear not to have decided yet what to do with the agreement, which also required North Korea to come clean about its past plutonium work before the nuclear components of the reactors are in place, and to uphold an earlier accord with South Korea banning the enrichment of uranium. Presented with the evidence of their uranium enrichment, North Korean officials reportedly told the Americans that they consider the 1994 reactor deal “nullified”. But for their part, the Chinese do not want it scrapped. They believe the accord has been effective in cutting off a ready supply of plutonium.

South Korea has sent a clear signal that it wants the problem to be resolved through dialogue. In an agreement reached in Pyongyang on Wednesday between senior officials from the two Koreas, it was agreed that the two sides would “actively pursue dialogue” to resolve the nuclear issue—though the South has not yet persuaded the North to scrap its uranium enrichment programme. President Kim Dae-jung, the architect of South Korea's “sunshine policy” towards North Korea, would be unlikely to agree readily to any threat of sanctions or want to see America cut off the 500,000 tons of heavy fuel oil that it has been expected to provide every year under the 1994 agreement until the first of the new reactors is built. A shipment of this oil went ahead last week, without being blocked. But South Korea's policy toward the North may change after presidential elections in December in which a conservative candidate, Lee Hoi-chang, is favourite to win.

For much of the past decade, North Korea's neighbours have lived with the possibility that some of the country's plutonium might have been turned into bombs. Yet they have generally tried to improve ties with North Korea rather than isolate it. During his meetings with Asian leaders, Mr Bush is likely to find little appetite for confrontation. Yet South Korea and Japan also know they cannot get far in their own relations with North Korea without America's backing, and Mr Bush will be looking for their diplomatic support in persuading North Korea that further aid and investment will not be forthcoming if it continues to cheat on its agreements.

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Japan and North Korea

# Nukes are not normal

Oct 24th 2002 | TOKYO
From The Economist print edition

**The Japanese public will not take kindly to cosying up to the North**

BEFORE the nuclear news broke, Japan and North Korea seemed to be on the way to a reconciliation. Last month Junichiro Koizumi made a visit to Pyongyang, the first by a Japanese prime minister. While he was there, Kim Jong Il confessed that his regime had abducted many Japanese over the years, and that only five of them were still alive a quarter-century later. The two then signed a joint declaration in which Japan apologised for “the huge damage and sufferings” it had inflicted on Koreans during its colonial occupation, and which expressed the two governments' desire to work towards normal diplomatic relations. But last week, while they were preparing to hold talks (which will start in Kuala Lumpur on October 29th), the Japanese public learned of North Korea's latest nuclear shenanigans. As Mr Kim's team prepares to sit down with Japan's government, it should now expect 123m uninvited guests.

The Japanese public's awakening has come gradually, spurred by occasional jolts such as the latest nuclear revelations. North Korea's missile programme, for example, went largely unnoticed by laymen until four years ago, when Mr Kim's regime decided to launch a rocket unannounced over Japan. By last December, when a North Korean spy ship sank with Japan's coastguard in pursuit, ordinary Japanese were paying closer attention.

Even before Mr Koizumi announced his trip to Pyongyang, 64% of Japanese were telling pollsters that they dislike North Korea. That compares with only 28% or so for Russia (respondents to the poll could name as many unlovable countries as they wished), and only 15-21% who dislike China, which many Japanese assume is about to devour their economy. Just because they fear and dislike their neighbour does not mean that Japanese would prefer to stay hostile indefinitely. But it serves as a warning to Japan's leaders not to get too far out in front of their voters.

Mr Koizumi's trip gave him an immediate boost in the polls; but soon afterwards, as the fate of some of the abductees became known, 76% of Japanese were saying that Japan should be in no hurry to normalise relations, and should “negotiate in a tenacious manner”. They are unlikely to have been better pleased, in the only country to have been bombed with atomic weapons, by news that Mr Kim is still toying with nukes. An unseemly struggle over the future of the surviving abductees has also developed.

Besides their outlook on North Korea, Japanese attitudes towards any talks will also be coloured by a growing distrust of their own officials. In the past year alone they have heard tales of incessant corruption and insubordination in the foreign ministry, learned how a politician manipulated foreign policy for profit, and watched a newsreel which showed officials in their Chinese consulate allowing Chinese police to haul off would-be defectors from what they know is a vile North Korean regime. Since they now distrust both sides at the negotiating table, ordinary Japanese and their media would look askance at any agreement that does not ensure their safety.

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Indonesia

# After Bali

Oct 24th 2002 | JAKARTA AND MANILA
From The Economist print edition

**The government seems to have the will to take on terror. How about the skill?**

Get article background

IF THE September 11th terrorist attacks last year changed the world, the October 12th bombing in Bali has certainly changed Indonesia. Before, the local authorities did not even acknowledge the existence of Jemaah Islamiah, a group accused by America and Singapore of launching various terrorist attacks, and refused to arrest the group's alleged leader, Abu Bakar Basyir. But in the two weeks since the attack, police have detained Mr Basyir (on his hospital bed), and Indonesia, among other countries, now wants the United Nations to declare Jemaah Islamiah a terrorist group. What's more, the government, which had spent months in fruitless negotiation with parliament over a counter-terrorism law, has summarily awarded police new powers to monitor, arrest and detain suspected terrorists. All this is proof, foreign observers hope, that Indonesia will now put its weight behind the efforts of other South-East Asian countries to combat terrorism. But as the experience of those other countries demonstrates, political will alone will not get the job of quashing extremism done.

The investigation into the Bali bombing is a case in point. The police made a good start by drafting in Made Mangku Pastika, a native Balinese who until then had headed the police in Papua province, to run the show. He had proved his grit by implicating several soldiers in the murder last year of the leader of the Papuan independence movement. With the help of dozens of foreign experts, the police have already identified the car that was carrying the bomb and issued sketches of its occupants.

But not everything is going according to plan. Much potential evidence was destroyed thanks to the police's failure to seal off the site of the bombing to prying journalists and grieving bystanders. Grisly bureaucratic delays in the identification of bodies have exasperated foreign governments and infuriated the victims' families. Meanwhile, the minister of defence, the police and the intelligence service have all released contradictory accounts of the investigation and then denounced one another's idiocy for doing so.

Indonesia has had little success cracking terrorism cases, despite the many bombings since the fall of Suharto, Indonesia's dictator for 30 years, in 1998. Until then, the intelligence service and the armed forces kept close tabs on extremist groups. But over the past four years, their budgets have been slashed, and the new liberal political climate has forced them to drop their more brutish tactics. The police have been hived off from the army, leaving them with no intelligence arm of their own. “I have to be honest,” says General Sudrajat, an army bigwig, “Our intelligence organisations are in bad shape.” Muchyar Yara, a spokesman for the intelligence agency, bears him out: “We lack human resources, money and equipment, so we can do only the minimum.”

Much of this self-effacement is self-serving. The different security services are exploiting the Bali bombing to lobby for greater powers and resources. The intelligence agency wants the freedom to interrogate suspects in the absence of police and lawyers. The army says it should be allowed to use its nationwide presence for surveillance work. The new decrees permit the police to hold suspects for up to six months without trial, provided they secure a judge's approval. Indonesia's past, though, makes such measures particularly sensitive. Human-rights groups point out that Indonesia's trouble with terrorism lies not with the courts acquitting obvious villains (none has), but with the authorities not bothering to pursue them. The police, moreover, originally said they needed their new powers to deal with people like Mr Basyir, who has only been implicated in terrorism by foreign intelligence reports. In the end though, they arrested him under the normal criminal code.

Nonetheless, the chief threat to the government's anti-terror campaign comes not from human-right

concerns or the Muslim opposition, but from its own short attention span. It tends to act only when it cannot decently do otherwise, leaving matters to lapse again as soon as the original uproar has subsided.

Yet the example of the neighbouring Philippines shows how little hope there is of a quick fix. President Gloria Arroyo has kept a crusade for “peace and order” at the top of her agenda for the past two years—yet terrorist attacks remain commonplace. There have been five bombings in the past month alone, causing 21 deaths. Although four of them took place in the south of the country, where various Muslim militants are fighting for independence, the other killed two passengers on a bus in Manila, the capital. Filipino officials say the latter resembled a series of attacks in 2000, blamed by jailed terrorists on Jemaah Islamiah. If their suspicions are correct, the group remains active in the country despite a concerted investigation and several arrests. As Angelo Reyes, the defence minister, admits, anyone who places great faith in the intelligence services ought to have his head examined.

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Bangladesh

# Reassuring America

Oct 24th 2002 | DHAKA
From The Economist print edition

**It denies providing a safe haven for terrorists**

THE government of Bangladesh is indignantly defending itself against claims that over the past year the country has been used as a safe haven for members of the Taliban and Osama bin Laden's al-Qaeda organisation. *Time* magazine said this month that Bangladesh may become a dangerous new front in America's war against terror. Ministers and officials are especially upset over a claim by an intelligence official in Dhaka, not named by the magazine, that Mr bin Laden's second-in-command, Ayman al-Zawahiri, may have been hiding in the country for months. The magazine said nearly 150 members of the Taliban and al-Qaeda fled from Afghanistan and arrived by ship in Bangladesh last December. The government denies this and says that such reports are an attempt to damage Bangladesh's tolerant reputation.

Unconnected to the magazine's story, but also worrying the government, are claims made by the main opposition party, the Awami League, that two Islamic parties within the governing coalition have a history of links to terror groups. It says that a bomb attack in September in the south-western town of Satkhira, when two people were killed and hundreds injured, was carried out by an Islamic group with links to the government. “We cannot hide from the truth,” said the Awami League's spokesman, Saber Hossain Chowdhury. “Unquestionably there are certain elements in Bangladeshi society—it may only be very small elements—who were sympathetic towards the Taliban.” Even some ministers were sympathetic towards the Taliban, he said.

The four-party coalition led by the Bangladesh Nationalist Party of the prime minister, Khaleda Zia, has strongly rejected the opposition claims. Mrs Zia says supporters of the Awami League were responsible for the Satkhira bombs. Such exchanges are the stuff of everyday Bangladeshi political life, made more pronounced by the bitter rivalry between Mrs Zia and the Awami League leader, Sheikh Hasina. But over terrorism, Mrs Zia has been particularly defensive, emphasising her co-operation with the United States.

One institution that is willing to assist the prime minister is the army, which has detained more than 1,500 people—including Mr Chowdhury—as part of a crackdown against murder, rapes, muggings and, say the opposition, dissent. There are said to be more than 300 murders in Bangladesh every month. Mrs Zia won last year's election largely on a promise to reduce violent crime. Last week, after it was clear that she had failed, the government ordered 40,000 troops on to the streets to help the police arrest armed criminals.

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**Afghanistan's constitution**

# The sound of the sixties

Oct 24th 2002 | KABUL
From The Economist print edition

### How will Afghanistan balance tradition and modernity?

**Get article background**

THE appointment on October 5th of a committee in charge of drafting Afghanistan's new constitution has so far not attracted much attention. It should. The Taliban may be out, but what kind of country Afghanistan is to become, and what place religion will have in it, are still crucial open questions.

Reuters

**Changing times**

At their Bonn meeting in December 2001, Afghan representatives and interested foreign countries revived with modifications the country's 1964 constitution, intending it as a stop-gap until a new one could be adopted. Enacted by Zahir Shah, then king, that constitution limited the monarch's absolute power through the creation of a parliament and the clear separation of powers, and granted equal rights to men and women. Following the coup that deposed the king in 1973, however, it was scrapped, as Afghanistan successively turned into a republic, a Soviet-style regime, an Islamic state and, under the Taliban, an Islamic emirate subject to the authority of an emir, Mullah Omar.

Over the next six months, the committee's nine members are to prepare a draft constitution, which will then be debated by a commission of 30-35 members. The final text must be ratified by a constitutional *loya jirga* (grand council) next year, paving the way for a general election.

In the months to come, however, tensions are likely to arise over the weight accorded by the new constitution to *sharia*, or Islamic law. In Afghanistan's conservative society, religion has proved to be a useful tool for warlords, many of whom gained power through waging *jihad* against the Russians and have held on to religion to maintain their influence.

Those who contributed to the defeat of the Taliban are now being accommodated for the sake of stability. Last June, unelected warlords were allowed to participate in the *loya jirga* that dominated the current government, and many delegates complained of being intimidated. Conservative elements led by Abdul Rasul Sayyaf, a warlord who destroyed much of western Kabul in the early 1990s (though he still teaches religion at Kabul University), insisted that the provisional administration be designated as “Islamic”. According to a UN official, this “is a message to the Afghan diaspora that this is a conservative society where western ideals should not be adhered to.” Also in June, Sima Samar, the former minister for women's affairs, was summoned in front of a court for blasphemy, after allegedly telling a Canadian magazine that she did not believe in *sharia*. The charges were eventually dropped for lack of evidence.

Moderates fear the growing influence of religious conservatives over the judicial system and regard Fazul Hadi Shinwari, the chief justice of the Supreme Court, with suspicion. He believes that Koranic punishment such as hand-chopping and stoning should be applied, although with more restraint than under the Taliban. A commission on judicial reform, established several months ago, was dissolved, reportedly obstructed by religious hard-liners. The infamous “Ministry for the Promotion of Virtue and Prevention of Vice”, the Taliban's ruthless religious enforcement agency, has never been abolished, although it has lost its ministerial status and is now known as the Department of Islamic Instruction.

The battle extends beyond the courts. In August, the head of Kabul Radio and Television decided to ban Indian films and the broadcasting of female singers. That decision was overturned by the more moderate minister of information and culture, but when Indian musicals made it back to Afghan screens, scenes including women singers were edited out.

So discussions over the constitution and the role of *sharia* promise to be contentious. Although the nine-man drafting committee is mainly staffed with moderates, the conservatives will flex their muscles when the wider constitutional commission is convened. It could be a long time before Afghanistan returns to the relatively progressive style of 1964.

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India

# When religion and freedom clash

Oct 24th 2002
From The Economist print edition

## Tamil Nadu bans forced conversions

IN AN effort to discourage the conversion of low-caste Hindus to Islam and Christianity, the government of the southern Indian state of Tamil Nadu passed a local law on October 5th banning such conversions if they are made by force or “allurement”. Signalling a break with the state's history of tolerant secularism, the move has been widely seen as an attempt by the chief minister, Jayalalitha Jayaram, to strengthen her ties with India's ruling Hindu-nationalist Bharatiya Janata Party, which has long advocated a ban on religious conversions. Those convicted will face a fine of up to 100,000 rupees (about $2,100) and up to four years in jail.

The ban appears to have been prompted by the conversion to Christianity in September of a number of untouchables, mostly women, in the Tamil Nadu city of Madurai. Then a group of low-caste Hindus in a village near Kanchipuram threatened to convert to Islam after they were prevented from worshipping in a nearby Hindu temple. The state's best-known case occurred in 1981 when an entire village of untouchables converted to Islam. While Hindu nationalists claimed that the converts were bribed, a government investigation concluded that they probably simply wanted to cut free from the discriminatory caste system.

For some, conversion is a means of improving their social and economic status. While the Tamil Nadu government says that the ban will counteract attempts to create communal tension under the banner of religious conversion, Christian and Muslim groups argue that it will simply infringe on a person's constitutional right to practise and propagate any religion of their choice. On his visit to India this month, the pope stressed the need for religious freedom. However, his call on his followers to further the spread of Christianity may have heightened Hindu nationalists' fears of future mass conversions.

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Japanese politics

# Not so magnificent

Oct 24th 2002 | TOKYO
From The Economist print edition

**Seven by-elections pose a problem for Junichiro Koizumi**

Get article background

THE Liberal Democratic Party, the head of Japan's ruling coalition, has been reeling this year from scandals that forced some of its most prominent members of parliament to resign. Partly as a result, voters turned against LDP-backed candidates in several local contests earlier this year, electing or nearly electing outsiders as mayors and governors. These upstarts tapped into voters' disgust by running without party ties or as members of the small but independent-minded Communists. Yet as Japan prepares for a series of parliamentary by-elections on October 27th, the ruling coalition has done little to clean up its act.

Nowhere is this more evident than in Yamagata, a rural prefecture on the Japan Sea coast that lost one of its MPs, Koichi Kato, to financial scandals this year. Mr Kato was the head of an LDP faction before he resigned his seat after one of his aides was involved in a tax evasion case and there were accusations of misused political funds. In the contest to replace him as MP for Yamagata's fourth district, a feud has developed between a group of local LDP members and the national party.

This battle makes it especially hard to gauge an election already marked by splits within the LDP leadership. One such became public when the prime minister, Junichiro Koizumi, shuffled his cabinet on September 30th. He angered LDP officials by refusing their advice on appointments. On October 22nd the man he had named as the new bank regulator, Heizo Takenaka, duly ran into LDP opposition over his ideas for dealing with bad loans, and had to delay publication of his blueprint.

Such confusion partly explains why Mr Koizumi's rebounding popularity has not given the LDP a clear edge in polls predicting the result of the seven coming by-elections. According to *Yomiuri Shimbun*, Japan's biggest daily, the prime minister himself is well supported in all the districts where the by-elections are taking place, with approval ratings of 53-65%. Yet in a number of these districts the LDP's candidates are not doing nearly so well.

In Yamagata's fourth district, only 30% of Mr Koizumi's supporters say they will back the LDP's new candidate, Takayoshi Sagae. He is a 57-year-old lawyer in Tokyo, specialising in intellectual property. He ran as a candidate in Yamagata for the now-defunct New Frontier Party in 1996, and for the Democratic Party in 2000. Both times he lost heavily to the LDP's Mr Kato. Unfortunately for Mr Sagae, it appears that attacks he made on the LDP when he was a Democratic Party candidate are now being held against him.

Critics of Mr Sagae in the local LDP caucus are mainly supporters of Mr Kato. They are hoping Mr Kato will eventually stand again for parliament, and think that Mr Sagae is getting in the way. Having toured the district making apologies for the financial scandals he has been linked to, Mr Kato is now lying low. “We don't care much about who will win this election,” says a local prominent supporter of Mr Kato, “because we are already focusing on the next.”

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China

# The antique that Mao destroyed

Oct 24th 2002 | BEIJING
From The Economist print edition

**A regretful Beijing is rebuilding its ancient wall**

FIFTY years ago, when China's newly triumphant revolutionaries proposed demolishing Beijing's ancient city wall, Lin Huiyin was appalled. “It will be an irreversible mistake,” the architect told the Communist authorities. “One day you will regret it, and you'll end up building a fake antique in its place.” Miss Lin scores points for her prescience, but not her persuasiveness. By the time she died in 1955, destruction of Beijing's 500-year-old wall was already under way. It was probably the largest and most complete city wall left in the world, but by the late 1960s there was little left save the elegant gate buildings strung out along the ring road built in its place.

Now, true to Miss Lin's prediction, a regretful city government is erecting a replacement. A mile-long segment of the wall, on its old south-east corner, has risen again. Officials say more bits of wall may be restored in future. Miss Lin's son, Liang Congjie, takes little solace in seeing his mother proved right. “It is just what my mother said, a fake antique,” he said.

Though it may already be too late, Beijing is now coming to terms with how much of its rich past is lost or threatened. The city has earmarked tens of millions of dollars for the preservation of ancient temples, bridges, palaces, towers and gardens. It also aims to save some of its remaining traditional residential courtyards. New building, the growth of population and the rising use of cars have all helped to destroy Beijing's distinctive narrow-alleyway neighbourhoods. But much of the destruction has been because Mao Zedong's revolutionaries sought to transform the imperial capital into a socialist showcase.

Mei Ninghua, the director of Beijing's Cultural Relics Bureau, acknowledged this month that the early Communists were short-sighted in their enthusiasm for destroying so much of old Beijing. The city's heritage will be better protected from now on, he said. Yet the needs of residents for such amenities as light and water have tended to conflict with the demands of preservation. Unlike the tourists and historians, who find Beijing's old neighbourhoods quaint, those who live in the alleys and courtyards often find them barely habitable. Until now at least, no one seems to have considered spending money to install water, sewerage and power. Easier to pull down the old, and build anew.

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Kenya

# Après Moi, le déluge?

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From The Economist print edition

Reuters

**Kenyans will not miss their veteran ruler, but fear what may follow**

AFTER 24 years, Daniel arap Moi is losing his grip around Kenya's throat. In the past, he has always won elections by dividing the opposition, but this week his opponents settled on a single candidate to fight the next presidential poll, expected in December. Mr Moi is constitutionally barred from standing again, but he had hoped to slip a pliant successor, Uhuru Kenyatta, son of Kenya's founding father, on to the throne. Against a united opposition, however, Mr Kenyatta stands little chance. A recent poll gives the challenger, Mwai Kibaki, the support of two-thirds of voters in a two-horse race.

It is obvious why Kenyans might wish to be rid of Mr Moi. His system of patronage has turned Kenya from one of Africa's most promising countries into one of its poorest. His habit of inflaming tribal grievances has sparked scores of small, unreported wars throughout the country. So badly and crookedly managed are state-owned companies that electricity, as Mr Kibaki noted in his first campaign speech, is eight times costlier than in Egypt. Kenya's roads have wasted to moonscape, and its people grow steadily poorer.

Take Julius. He is bright, articulate, and educated, but stuck swabbing floors for $70 a month. He is relatively fortunate; most Kenyans have no job at all. But Julius does not feel lucky, rearing three children in a hut which would barely pass muster with western animal-rights campaigners, and blowing his savings every time one of them develops bronchitis.

Amazingly, however, Mr Moi still seems to think himself popular. Expecting no serious resistance, he chose the inexperienced Mr Kenyatta as his successor, partly for his name, and partly because he is indebted to Mr Moi, who never pursued the Kenyatta family for the vast wealth they accrued while Mr Kenyatta's father was president. Mr Moi is perhaps counting on the junior Kenyatta to return the favour. But this strategy will not work if Mr Kenyatta loses the election, as seems likely, not least because Mr Moi split the ruling party, KANU, by nominating him.

## Parliament of cynics

KANU has no ideology besides the desire of its members for power and in many cases the freedom to abuse it. Its leaders represent between them all the main tribes, and rely on their own kith for support at

election time. Mr Moi has always controlled the party by securing each tribal leader's loyalty and fostering distrust among them all. But as he nears the end of his term, his powers of patronage are waning. And he has upset several KANU bigwigs by publicly humiliating them.

He effectively ditched George Saitoti, a former vice-president, at a televised party conference. He insulted Raila Odinga, a former minister and presidential aspirant, at a rally in Mr Odinga's hometown. Partly because of such slights, several big men quit KANU and joined with the main opposition parties to form the “National Rainbow Coalition” (NARC). They took with them enough members of parliament to leave KANU without a majority for the first time since independence in 1963. A motion of no-confidence in the president was then tabled. Mr Moi knows he will probably lose, so he is expected to dissolve parliament, which will oblige him to set a date for the polls.

Mr Moi is using all the apparatus of state to campaign for Mr Kenyatta, but things are not going well. He holds rallies to present Mr Kenyatta to the electorate, but these rallies have often been interrupted by jeers. So a change of government seems likely. Unfortunately, the new opposition appears not to have many more policies or principles than KANU. It is, for example, the fifth political group that Mr Odinga has joined in the past six months. Mr Kibaki, NARC's leader, is a wealthy former vice-president about whom one western diplomat, searching for something positive to say, muttered that he “might care about the future of Kenya”. His followers are united only in their loathing of Mr Moi, so the new party could yet split. But if it doesn't, Mr Moi may be driven to desperate measures.

In the run-up to the last two elections, perhaps 2,000 people were killed in ethnic clashes stirred up by Mr Moi's pals. This year, there are signs of more of the same. In August, a gang of dread-locked gangsters from Mr Kenyatta's Kikuyu tribe, numbering in the thousands, rallied menacingly in Nairobi, the capital, in support of their man. An escalation in political violence would be a risky strategy. It would make victory imperative for Mr Moi's future well-being, but it would not guarantee such a victory.

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Iraq

# Amnesty: irrational?

Oct 24th 2002 | BAGHDAD
From The Economist print edition

**Saddam Hussein's reign of terror lapses, briefly**

EPA

**Out of one prison, into another**

JUDGING from its own press, Iraq is basking in a national love story. Last week, the masses endorsed their idol, Saddam Hussein, with a 100% yes vote in a presidential poll. Touched by their fervour, Mr Hussein responded by emptying his dungeons, freeing untold thousands of political prisoners, as well as thieves, murderers and army deserters.

The amnesty brought joy to Iraqi streets, but also perplexity. Was this really, as one prison officer declared, “the act of a father forgiving his children”? Or is Mr Hussein, in the face of American threats, grasping at ways to improve his image, both abroad and at home?

The chaotic scenes outside Iraq's prisons were real enough. On Monday, relatives who heard the news rushed to Abu Ghraib, a gulag on the outskirts of Baghdad. As the crowd shoved at the gates, guards fired into the air and lashed out with belts before finally giving way. At their hour of liberation, a few prisoners fleeing their cells collided with crowds surging in, and were trampled to death. Inside, the cells were strewn with broken eggs, upturned rice bowls and slop buckets. Only at the Special Judgment wing—the Orwellian term for the compound housing political and security prisoners—did the gates remain shut, until the president's foes filed out one by one.

Apparently real, too, were the scattered protests the following day outside Baghdad's Ministry of Information and secret police headquarters. “Where are our sons?” distraught mothers wailed before the world's press, before breaking into a chorus of hail Saddams when guards tried to shuffle them on. Two hours later, they were back, still demanding to know the fate of detained relatives. In a country where a husband fears pillow talk with his wife lest she betray him if they divorce, such a public display was brave. But unless Mr Hussein has indeed turned a new leaf, it was also unwise. Has he?

Most observers think not. Mr Hussein has not remained in power for 23 years by being nice. So why, then, has he released his own opponents? Perhaps he really believes the message that Iraqi telephones emit instead of a dial tone, that “the Iraqi people love Saddam Hussein!” Or maybe he is gambling that, at this stage of his endgame with America, showing confidence is more important than locking up rebels.

In Baghdad, a more common question is: why has Mr Hussein let such a large crowd of criminals back on to the streets? “I had three death sentences,” said one baffled murderer, as he emerged from his prison cage, adding that he was unsure what to do next.

The city's relatively well-to-do and largely Sunni Muslim western half already bars its windows against the *ashrougi*, the supposedly uncouth refugees from the Shiite south of the country who populate the malodorous and destitute eastern quarters of the capital. By stoking fears that American bombs and missiles would provoke looting and mayhem, Mr Hussein may hope to bolster middle class support for his rule.

The amnesty served other useful purposes, too. The released criminals and deserters will boost Iraq's depleted army and ragtag militias. And the accompanying announcement that freed murderers would still face tribal justice “in accordance with the custom of blood vengeance”, represents a further legitimation of the role of tribal chieftains. Mr Hussein has increasingly, and successfully, wooed these men, who hold sway over most of rural Iraq, as well as among city migrants, with gifts of guns, cars and land. Now they

are to act as law-enforcers as well.

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Angola

# Measuring corruption

Oct 24th 2002 | LUANDA
From The Economist print edition

## It's even worse than you thought

Get article background

NOTHING shocks Angolans. “It's normal,” said one, referring to the disappearance of $4.3 billion from state coffers in the past five years. But someone at the International Monetary Fund was clearly a little bit shocked, because an internal report making this and other detailed allegations, which was not supposed to be released without the permission of the Angolan government, was recently leaked.

Last year, according to the report, more than $900m was unaccounted for. This was about a tenth of GDP; as if American politicians had swiped $1 trillion. It is also roughly six times what the UN has received this year for such things as feeding the 2m Angolans left destitute by the recent civil war, inoculating them, and providing mine victims with false limbs.

Angolan officials deny everything, and proudly point to new measures designed to improve transparency, such as the recent launch of a website for the finance ministry. The government has also promised, since the civil war ended in April, to increase social spending and to reduce the defence budget. But who trusts it?

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America and the Arab world

# Education, still in demand

Oct 24th 2002 | CAIRO
From The Economist print edition

**Arabs don't like American policy but do like its education**

AMERICA used to sell well in the Arab world. Banks, cars, appliances, even a brand of tinned fava beans, Egypt's national food, boasted happily of their American origin. But with America threatening to strike Iraq, and with sporadic boycotts slashing sales of American goods, there is only one American product whose appeal remains undented: education.

Not only have venerable schools such as the American University in Cairo and in Beirut (AUC and AUB) prospered through decades of turbulence. Their success has spawned multiple imitations. Sharjah and Dubai, neighbouring Gulf cities, have both opened “American” universities, and nearby Qatar has just set up a branch of Cornell medical school, one of America's best. Beirut has added two more “American” colleges, and even the war-blasted Palestinian town of Jenin is home to a new Arab-American University.

Dozens of other colleges have adopted the style, if not always the substance, of American campuses. Philadelphia University is located not in the American city, but in Amman, Jordan (the original Roman city of brotherly love). The American Open University is indeed based in Virginia, but offers distance-learning in Islamic studies, in Arabic, and largely to Arabs. Even Egypt's giant and crumbling state universities have launched fee-paying special faculties where curriculum and accreditation are American.

## A ticket to success, or out

Knowledge is power, runs the motto of Cairo's new Misr University of Science and Technology (or MUST, as it likes to call itself). In a region with shocking levels of unemployment and lots of young people, knowledge of English means the power to get a better job, or perhaps to emigrate.

The success of American-style education is also a product of the failure of local brands. In their rush towards development before 1990, every Arab country hugely expanded free state universities. More people earned degrees, but at the cost of a plunge in quality. Since 1980, spending per student at Egypt's 15 state universities, with a current enrolment of nearly 1m students, has fallen by half. In the wealthy Gulf, a policy to replace the expatriate faculty with local staff has also lowered standards.

With demand for college education rising, many governments have reluctantly opened the doors to private enterprise. Egypt now has six American-style fee-paying colleges, Jordan and Lebanon a dozen more. Even strictly socialist Syria has started licensing private colleges.

American education received a further back-handed boost this year as hundreds of wealthy students, who normally would have studied in America, were scared off by stiffer visa requirements and tales of Arab-bashing. The number of applicants to AUB from Gulf countries, for example, has tripled.

More than anything, however, it is the academic reputation and social cachet of the older American institutions that inspires copycats. Since its founding by missionaries in 1866, AUB, whose leafy campus looks like Harvard-on-the-Med, has turned out 45,000 graduates. Distinguished alumni include a third of the current members of Lebanon's cabinet, a quarter of its members of parliament, the central bank governor and foreign minister of Jordan, and the Bush administration's hawkish special envoy to Afghanistan, Zalmay Khalilzad.

AUC, also founded by missionaries, started smaller and later, but has caught up fast. Both Hosni Mubarak's wife, Suzanne, and his son, Gamal, who is increasingly seen as Egypt's heir apparent, are AUC

graduates. In recent years, Microsoft has taken to plucking recruits straight from the university, which has the only fully American-accredited computer studies programme overseas. Egyptian job announcements in fields such as finance and public relations often specify that AUC graduates are preferred.

Things have not always gone so well for these institutions. AUC was briefly nationalised after the 1967 war with Israel, and had some windows broken during bread riots in 1977. AUB suffered far worse. During Lebanon's civil war, five of its American staff were kidnapped, one of its buildings was car-bombed, and its president and librarian were assassinated. An American ban on its nationals travelling to Lebanon, which lasted from 1987 to 1997, combined with cutbacks in American government funding, severely drained its resources.

Despite the current rise in hostility to America, officials at both universities are confident of escaping such calamities in the future. “We're basically seen as a local institution. What is American about us is only the style, content and philosophy of our education,” says John Waterbury, president of AUB, noting that it has never flown an American flag. When the university conducted social research in a Hizbullah-controlled Beirut slum, Hizbullah was helpful rather than hostile. Similarly, AUC is often attacked by Egyptian ultra-nationalists as elitist and alien, but its students last year collected 600 tonnes of drugs, blankets, food and other aid for impoverished Palestinians, more than any other charity in the country.

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**Swaziland**

# Is the king above the law?

Oct 24th 2002
From The Economist print edition

## Yes

IT SOUNDS like a schoolgirl's dream. Just as a class prepares for exams, two emissaries from the handsome young king walk in, and whisk off a pretty student to become his bride. Traditionalists in Swaziland believe that any girl should feel honoured to be picked as the 34-year-old King Mswati III's latest wife (he already has nine). But Zena Mahlangu's mother disagrees.

**The king won't take “no” for an answer**

This week, the High Court considered a case brought by Lindiwe Dlamini, Ms Mahlangu's mother, who claims that the 18-year-old queen-to-be was kidnapped by the royal flunkies, along with two other girls. It is not clear what Ms Mahlangu herself thinks, as she is shut up incommunicado in a palace. As she is still a minor under Swazi law, her mother, a public-relations manager at the post office, can claim to speak for her.

Taking the king to court would be difficult, since he is above the law, so Ms Dlamini is suing his two emissaries instead. The case has become a rallying point for feminists, who argue that Swazi customary law is a tad reactionary. Women cannot own land, take out loans or enter into contracts. Forced marriages are common. And the chief symbol of Swazi patriarchy is the monarch himself, who selects a new bride each year from among the hundreds of topless virgins who twirl for his pleasure at a ceremony called the reed dance.

One lawsuit does not make a revolution, but the monarchy is under pressure from other quarters, too. In August, the High Court freed Mario Masuku, the main opposition leader, who had spent a year in prison on charges of defaming the king. Incarceration does not seem to have chastened him. Last month, he said it was time for the royal government to be “wiped out”. This month, pressure from donors, who help feed tens of thousands of hungry Swazis, helped to persuade the country's normally toothless parliament to reject a plan to spend rather more than the food aid budget on a royal jet.

Perhaps most worrying for the king are his subjects' increasingly loud demands for a new constitution, to replace the one that his father suspended in 1973. When campaigners met in July to propose a modern, democratic system, one of the king's wives had the gall to attend, and to speak approvingly of the concept of the rule of law.

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# Correction

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In our issue of September 21st, we said that families separated by the war between Ethiopia and Eritrea communicate through the UN (see article). In fact, it is the International Committee of the Red Cross that provides this service.

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Enlarging the European Union

# The Irish agree; now will everyone else kindly do the same?

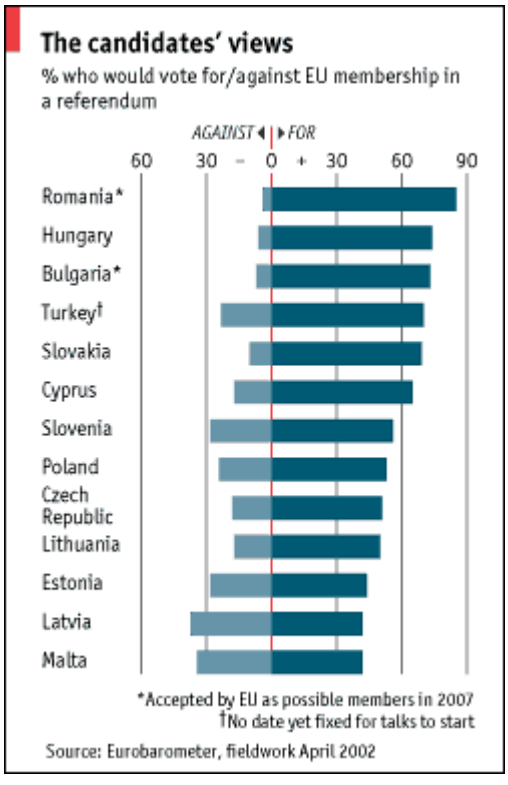
Oct 24th 2002
From The Economist print edition

**Ireland's voters have given the green light to EU enlargement. But EU members are not entirely at one with each other, let alone with all the candidate countries**

Get article background

AT THE second attempt they gave the answer the establishment wanted: by 63% to 37%, Ireland's voters—the half of them that bothered to vote—said yes to the European Union's Nice treaty, and EU enlargement, to take in ten new countries, can go ahead. Now for the hard part: sorting out the thorniest disagreements within the EU, and between it and the candidates.

The right result, maybe, achieved in the wrong way. In mid-2001, after a lacklustre campaign by the yes side—nearly all the parties, the trade unions, even the church—only 35% of the Irish electorate turned out, and, by 54% to 46%, they said no. So tell them to try again, add to the inducements a ban on neutral Ireland joining in any EU defence set-up, put in some real sweat and vastly more money—the dominant Fianna Fail party, which had budgeted *euro*60,000 in 2001, made that *euro*500,000 ($490,000) this time—and all, in the end, was well.




Sighs of relief from the candidate countries, from Brussels and from EU capitals (not least, Dublin itself, where Bertie Ahern, till now as skilled at losing referendums as winning elections, had been deep in local political trouble). But it was no triumph for democracy, as the Irish losers, cheated of their 2001 success, complained bitterly: and—look at the abstentions—no ringing endorsement of the EU. As even the Irish winners, and grander figures in the EU admitted, the Union's leaders must learn to carry opinion with them.

Still, a win is a win. The Danes, in the EU chair this half-year, were eager to carry the momentum forward at the EU summit that opened on October 24th—and would go on into the weekend, the Danes threatened, if the 15 leaders could not agree on the contentious enlargement issues.

Farm subsidy has been the largest of these. How far and fast should the farmers of the ten putative new members get their hands on the loot? The European Commission has proposed that direct payments to them should start at 25% of levels in today's EU countries, rising to 100% by 2013. Some countries, notably Germany, see this as a fat blank cheque and have been refusing to sign it without a guarantee that these payments would be revised, downward, EU-wide from 2007.

Next, exactly how are certain of the, mostly poor, newcomers to be saved from being net contributors—at least at the start, before other subsidies begin flowing their way—to the EU budget? And, longer-term, how big should these other subsidies be; translation, how much should places like Spain and Portugal give up to aid ones like Poland or Slovenia? More generally, who pays? France pointed at Britain's budget rebate. Not on the agenda, sniffed the British.

In sum, the EU countries went to Thursday's summit far from a joint position—let alone from selling it to the candidates in the mere seven weeks before the next summit, in Copenhagen from December 12th, where the Danes hope to have all but the fine print sorted out with the candidates.

Within the EU, public support for enlargement is strong: 60% or more, says Gallup, except in Finland, Sweden and Britain, and even in those countries the pros outweigh the antis by two to one. But it is the candidate governments that have to persuade their voters. In Malta and the three Baltic candidates April figures showed the pros 50% or less. That is still well ahead of the antis. But there are many don't-knows and waverers, and special interests that can be rubbed the wrong way; notably the farmers, especially in Poland.

Still, the road ahead, albeit potholed, is now open. Come March, in Greece, next holder of the EU presidency, the EU hopes to have the last fine print on paper and ten about-to-be members signed up.

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Terrorism in Russia

# The Chechens strike

Oct 24th 2002 | MOSCOW
From The Economist print edition

**Terrorists seize a Moscow theatre—and its audience**

Get article background

WOULD it end in a massacre? Or in a slow, painfully negotiated, messy, compromise? Whatever the outcome—still to be seen as *The Economist* went to press—almost certainly hopes for peace in Chechnya were wiped out this week when a group of up to 50 Chechen terrorists marched into a Moscow theatre on Wednesday evening and took more than 700 people hostage. Their demand: an end to Russia's three-year-old military campaign in Chechnya.

The immediate response from the authorities was to surround the theatre with troops, but to attempt to negotiate. Wisely: the terrorists claimed to have mined the building and were certainly well armed. Any use of force looked likely to provoke carnage, and Russia's elite Alpha troops do not have a good record: in a previous crisis, when they stormed a hospital that had been taken over by armed Chechens, 122 hostages were killed and the rebels eventually escaped with 150 more.

Wednesday's attack was by far the most daring rebel exploit in the decade-long history of the conflict in Russia's would-be breakaway republic. There had been hostage-takings before, including the capture of some 2,000 people in 1996. But all were in or around Chechnya itself, far from the centre of power in Moscow. Chechens were also officially blamed for the bombing of apartment buildings in Moscow and elsewhere that claimed the lives of 300 people, in 1999. No proof was offered (indeed some people thought this the work of the authorities, stoking up support for a second campaign in Chechnya), but most Russians were outraged.

This time, Russian public opinion is likely to harden even further. In his state of the nation speech in April, President Vladimir Putin claimed that the military operation in Chechnya was over, and handed responsibility for the region to the Federal Security Service, successor to the KGB. Nonsense, say independent observers: the Russians are still losing over 100 men every month. In August rebels shot down a military helicopter, killing 118 soldiers.

For Mr Putin, Chechnya has become a personal crusade. He has shown no enthusiasm to negotiate with the rebels, ignoring an olive branch offered by Aslan Maskhadov, the Chechen president, in August, and publicly slapping down Boris Nemtsov, a leading liberal politician, who had expressed Russian fatigue with the fighting by calling for an end to it. Mr Putin used the anniversary of the September 11th attacks on the United States to draw the parallel between the war in Chechnya and America's campaign against al-Qaeda in Afghanistan.

Even if Mr Putin wants them, though, peace talks now look impossible. There was never much consensus among the 20-odd Chechen clans that control the republic. Mr Maskhadov has only the loosest grip on power, and many field commanders do not recognise him as leader. Whether by design or not, the theatre affair looks likely to scupper his attempts to bring the fighting to an end.

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**Turkey and its Kurds**

# Getting just a little better

Oct 24th 2002 | VAN, EASTERN TURKEY
From The Economist print edition

**They aren't happy, but at least Kurds can vote for a party that speaks for them**

SOON after Gulsen Varisli, a 20-year-old student, petitioned her university to include Kurdish language courses in its curriculum earlier this year, she was summoned by her lecturers for a chat. The meeting had barely begun before she was hauled off to the gendarmerie headquarters in Van. “I was blindfolded, punched in the face, sworn at repeatedly for four days,” she recalls. When Miss Varisli refused to withdraw her petition, she was forced to sign a confession saying that she was a member of the Kurdish separatist rebel group, the PKK. She was sent to jail, and spent six months inside before appearing in court for the first time. If she is convicted on a charge of being a member of a terrorist organisation, she may go back to prison for a further three years.

Thousands of students across Turkey face similar charges for seeking the right to learn Kurdish. Some cases were launched even after the Turkish parliament, under heavy pressure from the European Union, in August passed a series of reforms that scrapped bans on broadcasting and education in the Kurdish language. This week, Abdul Melik Firat, a leading Kurdish politician, was detained in the town of Lice after addressing a rally in Kurdish. The reforms are just paper so far, and Turkey's estimated 12m Kurds remain deeply discontented, says Hasip Kaplan, a Kurdish lawyer, who is standing for parliament in the elections of November 3rd, on the ticket of Dehap, the Democratic People's Party.

This is the only pro-Kurdish group that will take part: the main Kurdish party, the People's Democracy party, Hadep, pulled out, fearing it might be banned on charges of acting as the political wing of the PKK. Dehap was set up by former Hadep members who teamed up with two small, non-Kurdish left-wing parties. They hope to draw votes from beyond their traditional Kurdish constituency. “We seek to fulfil the needs of all citizens, and the primary need is democracy,” says Mr Kaplan.

Few voters, Kurds or others, see any difference between Dehap and Hadep. For many Kurds, voting for Dehap is plainly the same as backing the PKK, and slogans exalting Abdullah Ocalan, the PKK leader, who was captured and sentenced to death on treason charges in 1999, are chanted at Dehap rallies across Turkey. The authorities think of Dehap much as the voters do, and Turkey's hawkish chief prosecutor tried to get the party disqualified from the elections on flimsy technical grounds.

The good news, for there is some, is that the courts turned him down, and that the slogans have not led to mass arrests, as they formerly would have; even Kurds admit that the authorities have been remarkably restrained during this campaign. And this week an Izmir court let off some of the accused would-be students of Kurdish. Turkey cannot even hope for EU membership unless it improves human rights, and the pressure is plainly having some effect in practice as well as on paper.

With the death penalty scrapped as part of the August reform package, Mr Ocalan will continue to live in solitary confinement in an island prison near Istanbul. In exchange for his life, he has been exhorting his followers to abandon their 15-year-long armed campaign, together with demands for Kurdish statehood. They have obeyed him, by and large, for the past three years. Dehap is now demanding an amnesty for some 10,000 prisoners held for PKK-related offences, as well as for a further 5,000 guerrillas holed up in the mountains of northern Iraq. And, with the rebellion over, Dehap is also calling on the government to live up to its pledges of more jobs and better living conditions for the millions of Kurds in Turkey's poor south-eastern provinces.

Might the Kurds even get a party voice of their own in parliament? Pollsters suggest that Dehap will draw about 8% of the national vote next weekend. That is nearly twice what Hadep got in the 1999 elections, but still short of the 10% threshold needed to win any seats at all.

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Spain's history

# Remembering the days of Franco

Oct 24th 2002 | MADRID
From The Economist print edition

**For years Spain has preferred to forget its decades of dictatorship. No longer**

“WE HAVE had so little chance to remember.” Thus a sympathiser of the losing Republican side in Spain's 1936-39 civil war, speaking to your correspondent at a rare ceremony held in 1994 to honour members of the International Brigades, foreigners who came to fight for the republic against the rebels led by Francisco Franco. But the situation he described then is now changing.

The Francoist past is not so distant: the *caudillo* held on to power until his death in 1975. But for most of the years since then memories have been brushed under the carpet. This autumn, however, an exhibition, several books, television and radio are giving Spaniards an opportunity to remember. And people of all ages, despite little official encouragement, are showing they want to do just that.

“I needed to tell my story,” said one listener who heeded the call of a journalist, Carlos Elordi, to recount memories of post-war Spain for a radio programme. The results go out once a week and have provided the raw material for a book. “It's an account of the terrible suffering that many ordinary people endured,” says Mr Elordi.

The current mood of retrospection does not centre on events of high politics or on the civil war itself. That ground has been well covered by foreign and home-grown historians. So too has Spain's transition to democracy, the subject of endless self-eulogies whenever a suitable anniversary comes up. It is, instead, a moving, painful and cathartic look at the decades of Francoist rule after the civil war, mainly from the perspective of the losers but also incorporating the experiences of those who made do and of those who left.

An exhibition, “Exilio” (Exile), follows their footsteps. It is a sorry tale which includes description of internment camps in France but also of welcome given by Latin American countries, of struggle to keep a government in exile and of eventual return. There are queues to get in to the exhibition, the tearful old often guiding the young, many of them brought up barely to know who General Franco was.

A book by another journalist, Isaias Lafuente, recounts how Franco used Republican prisoners as forced labour after the war. A novel, “La Voz Dormida” (The Sleeping Voice), by Dulce Chacon, set in a women's prison after the war, is dedicated “to those forced to keep silence”.

Some 60 communal graves of Republican fighters and sympathisers have been identified by a group called the Association for the Recovery of Historic Memory. They want to excavate them and turn the sites of the graves into proper memorials. “We're not motivated by hatred or revenge,” says the co-ordinator, Emilio Silva, himself the grandson of one of the victims. “We want to discover and keep records of what happened. Only then will we be able to declare the war history.”

Less harrowing is “Cuentame, como paso” (Tell me how it happened), a series on state television based on the day-to-day life of an ordinary Madrid family as Spain begins to change in the 1960s. The father, a man of humble origins, is unpolitical and wants to stay on the right side of the authorities. But his son becomes involved in student politics, while his daughter visits Carnaby Street and acquires a long-haired English boyfriend. His wife sets up her own business producing jeans and miniskirts, and the new priest turns out to be a reformer who disappoints his flock by showing Ingmar Bergman films that aren't racy enough. The series's affectionate, subtle but hard-hitting criticism continues to win it top ratings in its second season.

Why so much interest? And why now? Not least, because time is running short for those who do still remember. “People have not forgotten,” says Mr Elordi. “And, unlike in other European countries, in

Spain there has been no collective declaration of guilt or rejection of the past." The memorials in Spain almost all record only one side, Franco's victorious rebels.

The centre-right People's Party, in power since 1996, has discouraged attempts to pass motions in parliament condemning the Franco regime. The prime minister, Jose Maria Aznar, feels the past should be left well alone, and that the transition to democracy expurgated past sins. He has favoured a longer-term historical perspective, throwing public money at blockbuster exhibitions on Philip II and Charles V that show Spain in a powerful "European" light. His Socialist predecessor, Felipe Gonzalez, was none too keen on recent history either. His party argued—and maybe it was right—that if Spain was to move forward it needed to block out the past. Statues of Franco remained in place.

But today, with democracy firmly established and reinforced by membership of the European Union, there is little risk that a glance backwards will destabilise the country. It is, more likely, a necessary rite of passage with an element of overdue historical justice.

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**Ex-communist Germany**

# Hope for the east

Oct 24th 2002 | ERFURT
From The Economist print edition

**Its economy may do better than western Germany's next year**

AP

**The silver lining landed here**

Get article background

THE storm clouds that brought devastating floods to eastern Germany two months ago may prove to have had a silver lining: rather than harming the country's faltering economy, they may give it a slight lift. So say Germany's six leading economic institutes in their latest report on the outlook. They expect *euro*13.5 billion ($13 billion), public and private, to go into flood repairs, perhaps boosting growth fractionally, even though the government has postponed income-tax cuts and put a 1.5% special levy on corporate profits to raise cash for its *euro*7 billion flood relief fund.

The east, of course, will be the big gainer—and not before time. Nationwide, the institutes forecast no more than 0.4% growth this year, 1.4% next; but in the five eastern states they expect flood-related spending to spur growth to 2.3% next year, after six years when it has drifted at about 1%, half western Germany's rate—indeed last year and this barely moving at all.

Yet for how long? The ex-communist east has made big strides since unification in 1990, thanks largely to huge subsidies: some *euro*75 billion a year, about 4% of Germany's GDP. But it is still far behind the west: productivity is 30% lower, unit labour costs 10% higher; unemployment, at 18%, is over twice the western level. Infrastructure, though improved, is nowhere near western standards. And many of the brightest and best still go west for better opportunities and higher wages.

Yet the east is not a uniform block of unrelieved gloom. Pockets of excellence shine out, especially in the southern states of Saxony and Thuringia and around Berlin. Though the builders are in a long-running slump, manufacturers have been doing well. To keep wages down, the employers of nearly two-thirds of manufacturing workers have opted out of Germany's centralised wage-bargaining. With the aid of subsidies of up to 35% of the initial capital, this has pulled in outside investors.

Politically, the *Ossis*, as east Germans are called, are looking for the rewards of the support they gave Gerhard Schröder in September's general election: 40%—nearly five points up on 1998—against 28% for his conservative rivals. The government has already promised a new *euro*156 billion “solidarity pact”, to run from 2005 until 2019. It can do no more, and these days not even many *Ossis* believe that all they need to solve their problems is more cash. What they want is a higher profile and greater recognition in government.

Mr Schröder has appointed a leading eastern politician, Manfred Stolpe, to head a new super-ministry for transport, construction and “eastern redevelopment”. He has a full cabinet seat, unlike the junior (and unremarkable) minister for eastern affairs whom he has replaced. But it is still to be seen whether 66-year-old Mr Stolpe, who had been looking forward to a peaceful retirement after stepping down as premier of Brandenburg in June, will have the necessary muscle and imagination.

Much of what the east needs is what all of Germany needs: freer labour markets and lower non-wage labour costs, deregulation (eg, of shop opening hours), less red tape, reform of education and health, tax cuts and much else. Subsidies need to be less thinly spread and redirected into industrial “poles”—centres of research and innovation that would attract new companies and investors, as has already

begun to happen around cities like Dresden and Jena. So says Lothar Späth, head of Jenoptik, one of the east's best high-tech companies, who might have had Mr Stolpe's job if the conservatives had won last month. And so does the new government.

Behind these changes, a deeper one is going on: the *Ossis* are beginning to shed their specific eastern identity. Of course, they are still marked by their 40 years under communist rule, and still have many problems in common. The GDP per head of their richest state, Saxony, is still a quarter lower than that of the west's poorest, Schleswig-Holstein. But similarities with their western cousins are beginning to outweigh the differences. Bravo, say many go-ahead *Ossis*. Eager to break out of their east German identity, with its image of state-subsidised failure and endless complaint, the three conservative-led states in the south, Saxony, Thuringia and Saxony Anhalt, are now seeking to collaborate as a new, progressive “middle German” region at the heart of an expanded EU.

The collapse of the Democratic Socialists, direct successors of the east's old Soviet-stooge rulers, is another portent. Last month they lost a fifth of their supporters in the ex-communist areas, attracting only 17% of the vote. Hardliners, blaming the revisionists ready for closer co-operation with Mr Schröder's Social Democrats in state governments, have now seized control. They want to turn the party back into one of uncompromising opposition. But, with only two seats in the new Bundestag, against 37 before, can it survive? Mr Schröder has gleefully offered disillusioned Democratic Socialist voters a “new home” with his party. If the east can prosper over the next four years, many may take his offer up; and east and west will indeed be one.

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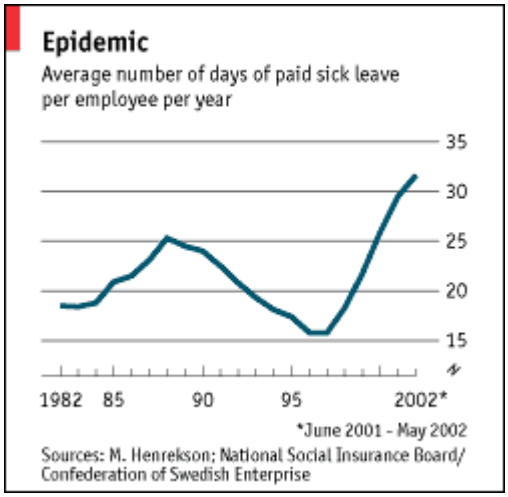
**Sweden's welfare state**

# Not healthy

Oct 24th 2002 | STOCKHOLM
From The Economist print edition

**Too many employees are off "sick"**




FOR a country with a fine public health service, Sweden's workers are a strangely unhealthy bunch. Now Goran Persson's newly re-elected Social Democratic government plans to cure them. But not with more doctoring.

In the European Union, on average, 1.9% of employees are off sick for a week or more in the year. In Sweden, 4.5%. Any weekday, near 10% of its workforce is off sick, and the total of days lost this way has doubled in five years. This year's budget forecasts costs of nearly $12 billion for sick pay and disability pensions—more than 10% of the government's total spending.

Why? Swedes smoke less, drink less and weigh less than most Europeans. They live longer. But they also have a wondrous welfare system. For his first day off sick, a worker gets nothing. But from the second, benefits—paid by the employer—run at 80% of pay, up to a monthly pay level of about $2,600; after two weeks, that normally reaches 90%, ten points of it from the employer, 80 points from the state; after three months, 80%, all state-financed.

So why work? Why indeed, asks Magnus Henrekson, of the Stockholm School of Economics: "It has to be profitable to go to work." He says that at the 90% level many employees actually profit by staying at home, since they avoid costs such as travel and meals out. He thinks even a modest cut to 75% would reverse the trend.

But it is that simple? An expert group set up by the government points out that Germany has much less absenteeism through sickness, even though, in some circumstances, workers can get their full pay. The experts highlight the high proportion of people aged 60 or more in Sweden's workforce. These, especially women, naturally figure disproportionately among the sick.

Maybe, but could it also be that Swedes are simply losing the work ethic? In a recent survey, 62% of employees said it was it okay to be off sick even when you're not. The government thinks otherwise, and on October 21st Mr Persson created a new ministerial post just to deal with the problem. The aim is to halve sick leave by 2008. More money is to be spent on rehabilitation and improving workplace environments. But checks on the supposedly sick will also be tightened. Stiffer medicine than that may yet be required.

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Charlemagne

# Reforming the EU's stability pact?

Oct 24th 2002
From The Economist print edition

**Many people now agree that the EU's budgetary rules are dangerously inflexible. But just try changing them**

IN RETROSPECT, it is clear that Romano Prodi was having doubts months ago. At a joint press conference last December, Guy Verhofstadt, the Belgian prime minister, declared that the European Union's "stability and growth pact" is "our bible". Sitting beside him, the president of the European Commission shifted uncomfortably. "Well, almost our bible," muttered Mr Prodi. Last week Mr Prodi came right out and said it: the pact is "stupid". The shock caused by this statement was understandable. For if the so-called stability and growth pact is indeed held to be the bible of the European Union, Mr Prodi as head of the commission, whose duty it is to enforce European law, is meant to be worshipper-in-chief. It was almost as if the pope had stood up and said that, on mature consideration, he had decided that the ten commandments were a load of nonsense. The repercussions, understandably, are still rolling on.

Many economists would agree with Mr Prodi that rules that force countries to cut public spending, even as their economies slow, are indeed stupid, if not positively dangerous. But a growing chorus saying that the pact is flawed is one thing. Agreeing to amend it is quite another. For the stability and growth pact is much more than a neutral mechanism for running the economies of the 12 countries that have adopted the EU's single currency, the euro. It is a political totem, a symbol that euro-using countries will not cheat each other. The difficulty is that these countries never really trusted each other from the start. In particular the Germans, with traditionally the strongest economy and currency in Europe, were loth to sign up to monetary union with Italy, given its tradition of mountainous debts, a weak currency and inflation. So before the great euro wedding, Germany insisted on a pre-nuptial contract written in blood: the stability and growth pact. The pact stipulates that all EU countries will run balanced budgets in normal times. And if any of the 12 that have adopted the euro ever lets its budget deficit exceed 3% of GDP, it will be forced back into line with the threat, ultimately, of huge fines—and in this bit of the pact there is no let-out covering times that are not "normal".

Mr Prodi is doubtless correct to point out that such threats are crude and inflexible. But that is precisely the point. Because the euro-area countries did not trust each other to behave responsibly, the pact was drawn up with as little room for creative interpretation as possible. The hope was that its dire threats would make it unthinkable for any country to breach 3%. Some hope. Portugal became the first to break the deficit limit by notching up 4.1% in 2001. Germany has accepted that it will cross the 3% threshold this year; rumours suggest that its deficit could be as high as 3.7%. Italy and France are getting dangerously near the trigger point; and the French barely pay even lip service to the requirement to balance their budget in the medium term.

One interpretation of Mr Prodi's "stupid" remark is that he was merely adapting to political reality. A more charitable interpretation is that he has had a genuine change of heart. As a former economics professor, Mr Prodi will understand better than most the arguments against the pact. In prepared remarks to the European Parliament, he wrote of the dangers of global deflation. Revealingly, however, that bit of his text was chopped from the spoken version, suggesting that the EU authorities are not yet ready to accept that inflation is no longer enemy number one.

Yet even if the intellectual argument for changing the pact were to be won, there would still be enormous political problems. Small countries that have made big efforts to balance their budgets are understandably resentful at the suggestion that larger, weaker-willed, countries may now be let off the hook. Consider the three likeliest ways of introducing some "flexibility" into the pact and the political obstacles immediately become apparent. One idea is to allow countries with relatively low overall levels of national debt more latitude to run budget deficits. But that idea is certain to be squished by the highly indebted Italians. Another idea is to be more tolerant of public spending that can be classified as "investment", while cracking down on structural deficits in current spending. But the obvious room for

creative interpretation of the word “investment” will make most countries wary. The simplest idea would be to scrap the 3% limit—or perhaps to raise it to 5%—to take account of new economic circumstances. The snag is that the deficit limit is written into European law, and any change would have to be made by the unanimous decision of all 15 EU members. There seems little prospect of that.

What is likely to happen instead is that, while the 3% limit will be kept in theory, it will be repeatedly violated in practice. In theory, that should lead to huge fines on malefactors. But read the small print of the treaties, and it becomes clear that the fines are more or less unenforceable. Portugal, the only offender formally named so far, would have to sin three years in a row before getting a fine—and even then the fines would have to be voted through by a majority of its fellow-members' finance ministers, many of whom might themselves be sinners by that stage.

## Learning by doing

The old-school defenders of the stability pact will maintain that the de facto crumbling of the fiscal rules underlying the euro represents the high road to economic disaster. Allow euro-area countries to run uncontrolled deficits, they argue, and we face a future of inflation and devaluation. Others respond that, in current economic circumstances, a sustained period of public deficits is just what the euro-area needs. The fact is, however, that there never has been a currency union between sovereign nations on this scale before, so no one can be certain what kind of fiscal rules will work best. “Learning by doing” is an excellent idea in a kindergarten. But it is a slightly alarming way of running the European economy.

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**Estelle Morris**

# Cabinet drop-out

Oct 24th 2002
From The Economist print edition

**Estelle Morris's replacement by Charles Clarke leaves no room for excuses**

**Get article background**

A GOOD teacher, but a dunce at top-level politics. Critics had plenty to say about Estelle Morris, the increasingly forlorn-looking education minister who resigned on October 23rd. Her own verdict on her performance was even harsher. It was, she said, “not quite good enough”.

It would have been much better had she remained as junior minister for schools, for which she was better suited. Hard-working, decent and experienced, she could criticise the prickly teaching profession more effectively than others.

But those same qualities, as she tacitly admitted in a touchingly honest resignation letter, did little to equip her to run a sprawling department. She seemed in thrall to the malevolently change-resistant educational establishment, gullibly accepting whatever advice it and her officials gave her. She displayed little intellectual confidence and readily retreated into swathes of miserable education-speak jargon. That the teaching unions should express great sorrow at her departure is the kind of double-edged compliment that a supposedly reforming minister might prefer not to receive. The customers—pupils and parents—are much less sorry.

There were blunders galore. Most recently, she misled Parliament about an earlier promise to meet new standards of literacy and numeracy by 2002. Ms Morris first claimed she had said no such thing. Then, confronted with the evidence, she admitted that she had. Only a couple of weeks earlier she had made an ill-judged intervention in a row about two rowdy boys who had been expelled from a school in Surrey. Before that she fumbled the biggest education issue of the year, about the chaotic grading of A-level papers. In between she made a bad screening system for teachers much worse, by insisting—in a headline-grabbing move following the murder of two young girls—to ban unvetted staff from the classroom.

Education is hugely important for Tony Blair's government. It ranks with health as one of the great targets for the second term. It is practically the only public service where the government has felt able to trumpet any real improvement. Reading and basic maths in primary schools have shown sharply better test scores. (Unfortunately, these began before Labour took power and have everything to do with old-fashioned teaching and little to do with splurging cash.) Turning that small success into a big one is proving difficult, especially in secondary education where little has improved. That would require

organisational ability, firmness of purpose, sureness of touch—none of which leap to mind when Ms Morris is mentioned.

The real problems with the government's education policy are not just about leadership or money, but the ideas behind it. For all Ms Morris's integrity and her niceness, she added to the powerful impression that the government doesn't really know what it's doing. Teachers are groaning under piles of silly paperwork. The dumbing-down of A-levels in pursuit of better-looking results is a scandal. There are far too many tests. The main new skill pupils are acquiring under Labour is how to pass exams, rather than how to think. Higher education is bursting at the seams thanks to the government's ill thought out notion that half the country's young people should go to “university” (and never mind what they find there).

**If even “education, education, education” is such a mess, what are the chances of the government's other attempts to reform and re-model the public services succeeding?**

A big job, then for the education minister who replaces her, Charles Clarke, a cabinet minister without portfolio and Labour party chairman. He is a tough and articulate though rather charmless advocate, who is capable of mastering any brief with authority. Whereas Ms Morris—unusually for a Blairite—got on well with the chancellor, Gordon Brown, Mr Clarke's relations are exceptionally bad. He will be glad of his predecessor's most notable achievement: a Treasury promise to raise education spending by 6% annually until 2006. Although Mr Clarke rubs people up the wrong way, that may, however, be just what is needed in education.

As to the wider question of where this unexpected and unwelcome cabinet change leaves the government, the answer must be just a little more damaged and less convincing than before. Although the departure of Ms Morris may help to draw a line under the dreadful muddles of the past few months, her resignation also draws attention to failure in an area where the government has highlighted its success. In particular, the prime minister's judgment is called into question. If even “education, education, education” is such a mess, what are the chances of the government's other attempts to reform and re-model the public services succeeding?

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Law reform

# Don't sue

Oct 24th 2002
From The Economist print edition

**Mediation is booming. London's overpriced legal industry must adapt**

LAWYERS love a good argument, preferably a long and therefore very costly one. What their clients want is something different: their problem solved, as quickly and cheaply as possible. That means looking outside the courtroom.

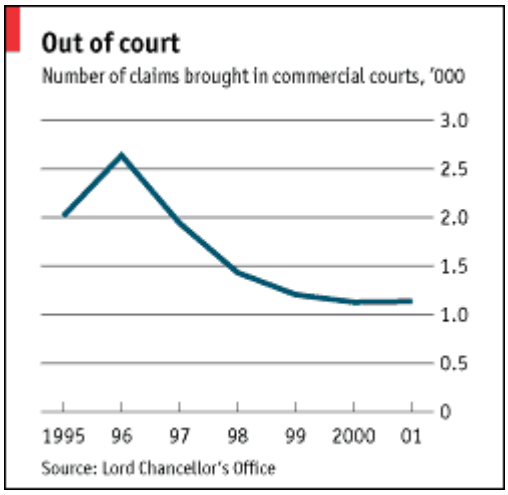
The new and fastest-growing alternative is mediation, in which an expert outsider nudges the parties, usually companies, to reach agreement. When it works, it normally takes a couple of days. It costs thousands of pounds, rather than the million or more that can be involved in a big court case. It is convenient and confidential—managers do not suffer the indignity of having their mistakes exposed in public.

The first big push towards mediation came in 1999, from government reforms making the early stages of a court case much more costly. “Going fishing—gratuitous litigation—has become much more expensive,” says Stephen Ruttle, a barrister who now mainly works as a mediator. The new rules also encouraged parties to sort out their disagreements without going to court.

Litigants who resist mediation can suffer for it. This year, for example, Railtrack lost an application for its legal costs, in a case it had won, because the railway-infrastructure firm had insisted on going to court rather than trying mediation first.

Sorting things out this way is now well-established in shipping, construction and insurance disputes, and is gaining ground fast. Around three-quarters of cases sent to mediation are settled. Because much mediation is private, there is no hard estimate about overall numbers. But business is booming for the country's dozen or so expert commercial mediators, while the number of writs served in the commercial court has fallen sharply (see chart).

The government is now planning new rules that will encourage public-sector managers to use mediation. Bureaucrats instinctively prefer going to court: if they lose, they can blame the lawyers. Going to mediation, by contrast, means taking more responsibility. Medical-negligence cases, in particular, are well suited to this approach. Going to court takes ages, is exhausting and miserable for both claimant and doctor, and the results are often a lottery. If successful, mediation can deliver what complainants often want even more than cash compensation—an apology, and assurance that the mistake will not happen again.




The boom in mediation comes amid increasing worries about London's future as an international legal centre. The main commercial court building, St Dunstan's House, is notoriously cramped, squalid and inefficient. Delays and high costs mean that some cases—chiefly, so far, patent hearings—have migrated to other, more efficient, jurisdictions.

In the longer term, there are worries about the quality of judges. The earnings gap between top barristers and the judiciary has never been greater, while judges' perks and status are declining. Although England still has a stellar reputation for the business-friendliness and honesty of its legal system, a continuing erosion of standards would encourage international companies to settle their arguments elsewhere.

If London continues to establish itself as a prime centre for mediation, it will fill some of the gap, but not all. Although big law firms have renamed their litigation divisions “dispute-resolution departments”, lawyers are not necessarily benefiting from the shift away from court. Without retraining, says Mr Ruttle, “barristers are usually rotten mediators, and judges even worse”. Lawyers, he says, are trained to give their clients answers, rather than bring them to agreement. Other professionals—personnel managers, say, or industry experts—are often better suited.

Indeed, an early step towards making a mediation session successful is often to get the parties' lawyers, with their vested interest in lengthy cases, out of the room. Businesspeople often find they speak a common language, especially when no one is pushing them to admit no fault and to stick out for the most they can get.

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**Humour**

# Tee hee

Oct 24th 2002
From The Economist print edition

**British self-regard on the subject of humour is hilarious**

THAT Britain lags behind America in trivia such as productivity, innovation, entrepreneurship and higher education worries few people. That the national sense of humour is supposedly hugely more sophisticated, by contrast, is a source of great pride. This week the *Daily Mirror*, the country's second-biggest tabloid, published an extraordinary apology to Steve Bing, a Hollywood film producer, who had tangled with a popular British actress last year. The paper had treated Mr Bing fairly robustly, even by the standards of the British gutter press. He sued for $40m.

This week, the *Mirror* published what seemed like a parody of a grotesquely grovelling apology—although it in fact used the exact text suggested by Mr Bing's lawyers in lieu of damages. To help any readers inclined to take it seriously, the paper ran a piece on a facing page on “Why Americans can't understand irony or sarcasm”.

It is true that the language used by American (and other) lawyers is almost beyond parody. And it is also true that many foreigners (not only Americans) find the dry, self-deprecating humour favoured by some Brits baffling and unfunny. The *Mirror*'s joke may backfire. Mr Bing's lawyers are extremely unamused and say they may sue again.

The punchline, though, is that the heyday of British comedy is long gone. There are no British shows to match the popularity and sales of American series such as “The Simpsons” and “Seinfeld”. Those patronising witticisms about America are tinged with envy.

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National Lottery

# Slim chance

Oct 24th 2002
From The Economist print edition

**Lottery players are rightly disgruntled**

HATE mail, death threats, xenophobia and insults—the past few weeks have been easily the most exciting in the eight-year history of the National Lottery. The row started when its operator, Camelot, blamed falling ticket sales on the Community Fund, which distributes 17% of the profits to charitable causes. The most serious mistake cited was a modest grant to a vocal group campaigning against the deportation of unsuccessful asylum-seekers.

The *Daily Mail*, a right-wing tabloid, picked up the story and urged middle England to express righteous indignation, in writing, to the fund. War heroes would be a more deserving cause than the gypsies, gays, foreigners and fraudsters favoured by the fund, it snorted. Among the postbag that the fund received were some vicious and obscene letters, and several stuffed with excrement.

Despite an advertising blitz, lottery ticket sales have plunged further, continuing the trend of the past four years. Takings for last Saturday's draw fell to less than £43m, an all-time low for a weekend rollover. After a two-month-long slanging match, the Community Fund approved the asylum-seekers' grant, on the condition that the charity remove anti-government slogans from its website.

Camelot says the rumpus has cost it £500,000 a week. That seems unlikely. The lottery has been giving money to unpopular causes ever since it started. A survey by the Consumers' Association has suggested that punters care little about where the donations go. The real reasons for the decline are likelier to be the growing awareness of the long odds of hitting the jackpot (14m-to-one), and an unattractive twice-a-week design. Better designed lotteries elsewhere in Europe are thriving, such as Spain's $1.25 billion Christmas draw, *El Gordo* (the Fat One), which is the richest in the world.

Last year, Spaniards bought more than 100m tickets for *El Gordo*, spending a total of $1.65 billion, or $40 per person. A staggering 98% of the population had either a ticket or a share in one; the five-hour draw—accompanied by a choir—rivals Christmas in popular imagination. Each ticket has a one-in-seven chance of winning a prize, however small. Colleagues, neighbours or relatives chip in for tickets to improve the chances of a big win.

In 1999, *El Gordo* brought $261m in prize money to a shoe-manufacturing town called Elche. Around a tenth of the 200,000 population won something; crowds danced in the streets. If Britain's lottery magnates want scenes like that, it is the cash payouts, not the iffy good causes, that they should address.

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**BBC funding**

# Tilting at aerials

Oct 24th 2002
From The Economist print edition

### A legal challenge to the BBC's empire

Get article background

WHY should the BBC be so coddled? Whether or not you watch its programmes, if you have a television set you must pay the £112 licence fee, or risk a fine. Tories find its news output stiflingly Blairite. The high-minded think it has gone irredeemably down-market. Others object to its extravagant commercial ambitions. The rural lobby has been thinking of a mass boycott in protest at the corporation's supposedly urban, lefty bias. Now a journalist on the *Sunday Times*, Jonathan Miller, has spotted a legal loophole in the Beeb's defences.

He is refusing to pay his £112 on the grounds that the 1998 Human Rights Act's definition of freedom of expression overrides the law that enforces collection of the licence fee. Freedom of expression, the relevant clause says, gives everyone “the right to receive and impart information and ideas” without interference by the authorities. The law specifically permits restrictions through broadcast licences. But that does not justify the British system of taxing television sets, any more than it would allow the government to tax spectacles to finance a favoured daily newspaper.

Mr Miller describes the BBC as a “noisome, overweight and anachronistic beast”. His employer, the BBC-hating international media tycoon Rupert Murdoch, presumably agrees. Now the beast must decide whether to risk a fight. The BBC is worried enough to have briefed one of the country's top lawyers, Lord Lester, to work out its defence. Perhaps it should think about different ways of raising money instead.

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Northern Ireland

# Guns away?

Oct 24th 2002 | BELFAST
From The Economist print edition

**Some IRA members are giving up. But not all**

Get article background

COULD the self-described “Real” IRA—a splinter group from the main outfit—be disintegrating? A message from behind prison walls by a bunch of the faction's members last weekend denounced its leadership as corrupt and called for disbandment. But disappointment followed quickly, with a grenade attack on a police station and tiresome bomb hoaxes in Belfast. In both cases, police thought they spotted Real IRA trademarks.

Despite the continuing menace, though, the Real IRA looks increasingly unreal. The title was meant to mock mainstream republicanism led by Gerry Adams, who took the IRA's political wing, Sinn Fein, into the now-suspended Belfast power-sharing administration. This was a sell-out, said the dissidents, claiming the mantle of unsullied resistance.

Since then, their record has been of wildcat violence, with no attempt at political argument. An August 1998 bombing in Omagh took 29 lives. Their most visible leaders were arrested. One of them, Mickey McKevitt, complained, bizarrely, that media harassment had made his children cry. That apparent loss of nerve, coupled with revulsion in republican heartlands at the loss of life, led the Real IRA to announce a brief ceasefire.

But violence soon resumed, including the high-profile rocket-propelled grenade attack on the London headquarters of Britain's foreign intelligence service in September 2000. This August, a Real IRA booby-trap killed a maintenance worker in a Territorial Army camp in County Londonderry, the first death since Omagh.

Many attacks have been aborted, however. The dissidents have struggled against infiltration on both sides of the border. The Irish *gardai* [police] have had particular success in recovering hauls of weaponry and helping to thwart a gun-running plan from the Balkans.

The main role of the Real IRA and other splinters is as a drag on Mr Adams's leadership; IRA bombers unhappy with the peace process have a ready-made new home. The police believe that a cohesive IRA under an authoritative leadership is more likely to maintain peace, however imperfect, than a messy disbanding that would strengthen the stragglers.

If the Real IRA is truly willing to give up, that should help Mr Adams meet Tony Blair's insistence that the mainstream IRA must now “go out of existence” to revive the peace process. The best Mr Adams has managed to date is to call for “all round demilitarisation”, by which he means further reform of policing and the removal of British soldiers from Northern Ireland, in return for some unspecified step by his side. That might include “standing down” the (literally) real IRA.

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**Roads**

# Stop digging

Oct 24th 2002
From The Economist print edition

**Roadworks are pestilential, and far too cheap and easy for the diggers**

GOODBYE Britannia. A line of traffic cones protecting a hole in the road would be the perfect emblem for modern Britain. The country's highways are plagued by countless excavations and street works, which to the fury of the natives and the bafflement of foreign visitors, seem never-ending. Now public impatience is boiling over, especially in London, where traffic congestion just gets worse and worse.

Anarchy reigns. Camden High Street in London has been dug up 144 times in a year; Glasgow's Great Western Road, 223 times. The record, however, appears to be held by London's most famous shopping thoroughfare, Oxford Street, with 288 times—more than one dig every working day. The Automobile Association estimates that there are four million holes in Britain's roads, half a million of them in London. Many appear to be deserted for weeks. Carl Powell, Westminster's director of transportation, describes the situation as “an unco-ordinated, uncontrolled nightmare.”

The holes cost £2 billion a year. A new study by Halcrow, a firm of consulting engineers, to be delivered to transport ministers this month, says three-quarters of the holes are caused by utility companies.

The root of the problem is the 1991 New Roads and Street Works Act. This liberalising measure has turned out to be an absurdly generous dowry for the newly privatised utilities, and for new cable television and telephone companies. Previously, there were only a handful of organisations with the statutory right to dig holes in the road. Extending these Victorian privileges to 100-plus companies has predictably resulted in chaos. Firms are obliged to notify local authorities when they intend to dig, but less than 5% of road works are advised a month in advance. All too often the utility just turns up and starts digging, claiming, spuriously, that there is an emergency.

The government's response to the public's growing ire has been to give selected local authorities the power to charge utilities which fail to complete their works on time. Unsurprisingly, this has proved ineffective. Big companies simply contest the fines in court, or pass the buck to sub-contractors. Another pilot scheme being tried out in Camden and Middlesborough, under which utilities are charged up to £600 a day for occupation of the road, has also proved disappointing so far. The head of Camden's highway-management department, Iestyn Faraday, says the council has not yet seen much change in behaviour.

Yet making diggers pay for the disruption is the right way forward. A report published last year by TRL, a respected transport-research organisation, reckoned that “substantial savings” of more than £1 billion a

year in indirect costs could be secured by less disruptive but only marginally more expensive methods of working. Most of Britain's international competitors make more use of trenchless and other advanced robotic techniques to avoid digging up busy roads (see chart).

**Just potty**

Rules on digging up roads

| | Right of entry | Charges | Time limits | Trenchless methods |
|---|---|---|---|---|
| Britain | Yes | None* | None | Not common |
| Japan | No | Yes | Strict | Pioneer, widespread |
| Germany | No | None | Strict | Leading user in Europe |
| France | No | Yes | Strict | Rare |
| United States | No | Yes | Strict | Rare |
| Hong Kong | No | None | Night-work only | Widespread |
| Scandinavia | No | None | Strict | Common |
| Singapore | No | None | Road holes banned | World leader |

Source: TRL

*Trials in operation

The National Joint Utility Group, a lobbying outfit, complains that its members are being made a scapegoat for traffic congestion. But so long as they defend their right to dig holes wherever they like, regardless of the disruption they cause, they can hardly be surprised that other road users want to lynch them.

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Bagehot

# Mr Blair's unsought fight

Oct 24th 2002
From The Economist print edition

**For all his tough talking, the prime minister has done his utmost to avoid a confrontation with the fire-fighters**

Get article background

IT'S a testament to how things have changed that, after nearly five and a half years in office, it is only now that the government is facing its first serious bout of union militancy. Not only does it have much at stake in its scrap with the bolshie leadership of the Fire Brigades Union (FBU), which plans to strike next week, but it is also entering largely uncharted political waters.

The rather mixed messages the government has been sending are some indication of this. At every opportunity, the prime minister reiterates his mantra that unprecedented “investment” in the public services is conditional on reform. Although he hasn't repeated for some time his use of the word “wreckers” to describe union leaders opposed to change, or mentioned recently the “scars” they have put on his back, he doesn't have to.

There is nothing new in Tony Blair's conviction that without big changes in the way the public sector works, most of the money he and Gordon Brown have committed to it will be frittered away. What has changed is that he now believes with certainty that those reforms must be the central and defining purpose of his second term. Iraq, Northern Ireland, third-world poverty and (a little less so these days) the euro all vie for his attention. But the thing that persuades Mr Blair of his own indispensability is his belief that “transformation” of the public services depends, above all, on him.

His speech to the Labour Party conference a few weeks ago, when he claimed to have lost his “love of popularity for its own sake”, was meant as a “no more Mr Nice Guy” warning to the assembled union leaders. Yet for all Mr Blair's apparent determination, the government has at times appeared to be sleep-walking into the greatest challenge to its authority that it has faced.

The government's response to the FBU's absurd claim for a 40% rise without strings was non-confrontational to a fault. It offered the fire-fighters an interim 4% pay increase, pending the outcome of an independent review into their pay and conditions set up under Sir George Bain, an academic who won union praise for his deft chairmanship of the Low Pay Commission. That was a clear sign of a desire to head off trouble. Since then, local government employers have promised—despite rumours that the award could be as much as 18%—to honour the review's proposals when it reports in December.

The justification for such largesse, especially when there are 40 applicants for every fire-fighting vacancy, was always going to be some far-reaching changes to the service's archaic working practices. Among others: a large part of a 48-hour week is eaten up by two 16-hour overnight shifts (mostly spent asleep), for no better reason than that this was when German bombers were likely to be at their busiest 60 years ago.

When the FBU decided to have nothing to do with Sir George's review and to press ahead with its plans to strike, the government seemed stunned. That was seven weeks ago and almost nothing has happened since.

In particular, the government's plans for maintaining an adequate service during a strike look half-hearted to the point of timidity. Nick Raynsford, the unfortunate junior minister responsible for the fire service, seemed aghast earlier this week at the suggestion that soldiers should be allowed to get their hands on modern fire engines and life-saving equipment instead of relying on the half-century-old relics known as “Green Goddesses”. That, Mr Raynsford said in hushed tones, would mean ordering troops to

cross picket lines.

The following day, his boss, John Prescott, the deputy prime minister, told Parliament that as it would take 12 weeks for soldiers to be adequately trained, taking over the fire stations wouldn't help much. Unfortunately for Mr Prescott, whose deep trade-union roots make him, in Mr Blair's view, the perfect choice for bruising with the FBU, his claim was promptly rubbished by the part-time fire-fighters union, which opposes the strike: ten days of training, it said, was enough.

Yet it is hardly any secret that a new generation of union leaders elected for their militancy has been spoiling for a fight. Some, like the FBU's Andy Gilchrist, are on the left of the Labour Party; others, like the rail union's Bob Crow, are a long way to the left of that. Mr Gilchrist proudly declared during his election campaign: “If we are one of the scars on Tony Blair's back, so be it.” Over the past few months, Mr Gilchrist has been busy urging his friends in other unions to ask their members to carry out workplace “risk assessments” in the event of cover no longer being provided by a professional fire service. Under health and safety legislation, work can cease if there is deemed to be risk of injury. To Mr Crow and others, who would like nothing better than to have a knock-down, drag-it-out fight with the government, the beauty of this is that it provides the excuse to spread disruption widely without breaching the laws brought in by Margaret Thatcher to ban secondary union action.

**It is hardly any secret that a new generation of union leaders elected for their militancy has been spoiling for a fight**

On some mornings, there is a part of Mr Blair which would cheerfully say to Messrs Gilchrist and Crow: “Go ahead, punks. Make my day.” He has already raised the spectre of Arthur Scargill, the miners' leader whose bloody defeat at Mrs Thatcher's hands helped pave the way for 17 years of industrial peace. Exemplary crushing of the FBU would send a timely warning to other public-sector militants as well as to members of the Transport and General Workers' Union and the GMB, who may be flirting with the idea of electing hard-left leaders.

It may still come to that. Mr Gilchrist has left himself without an exit strategy. But Mr Blair, despite what is sometimes said, is not Mrs Thatcher. If an acceleration of the Bain commission's findings could avert conflict, Mr Blair would be relieved—hence Thursday's last-ditch meeting between Mr Prescott and Mr Gilchrist. Mr Blair will destroy the FBU and its allies if forced to—he leads a powerful and, on this issue, united government. But he will do so without relish.

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# Securing the cloud

Oct 24th 2002
From The Economist print edition

**Digital security, once the province of geeks, is now everyone's concern. But there is much more to the problem—or the solution—than mere technology, says Tom Standage**

WHEN the world's richest man decides it is time for his company to change direction, it is worth asking why. Only rarely does Bill Gates send an e-mail memo to the thousands of employees at Microsoft, the world's largest software company, of which he is chairman. He famously sent such a memo in December 1995, in which he announced that Microsoft had to become “hardcore” about the Internet. In January this year Mr Gates sent another round-robin. Its subject? The importance of computer security.

Until recently, most people were either unaware of computer security or regarded it as unimportant. That used to be broadly true, except in a few specialised areas—such as banking, aerospace and military applications—that rely on computers and networks being hard to break into and not going wrong. But now consumers, companies and governments around the world are sitting up and taking notice. Why?

The obvious answer seems to be that last year's terrorist attacks in America have heightened awareness of security in all its forms. But the deeper reason is that a long-term cultural shift is under way. Digital security has been growing in importance for years as more and more aspects of business and personal life have come to depend on computers. Computing, in short, is in the midst of a transition from an optional tool to a ubiquitous utility. And people expect utilities to be reliable. One definition of a utility, indeed, is a service that is so reliable that people notice it only when it does not work. Telephone service (on fixed lines, at least), electricity, gas and water supplies all meet this definition. Computing clearly does not, at least not yet.

One of the many prerequisites for computing to become a utility is adequate security. It is dangerous to entrust your company, your personal information or indeed your life to a system that is full of security holes. As a result, the problem of securing computers and networks, which used to matter only to a handful of system administrators, has become of far more widespread concern.

Computers are increasingly relied upon; they are also increasingly connected to each other, thanks to the Internet. Linking millions of computers together in a single, cloud-like global network brings great benefits of cost and convenience. Dotcoms may have come and gone, but e-mail has become a vital business tool for many people and an important social tool for an even larger group. Being able to access your e-mail from any web browser on earth is tremendously useful and liberating, as both business travellers and backpacking tourists will attest. Corporate billing, payroll and inventory-tracking systems are delivered as services accessible through web browsers. Online shop fronts make it fast and convenient to buy products from the other side of the world.

## The price of openness

The flip side of easy connectivity and remote access, however, is the heightened risk of a security breach. Bruce Schneier, a security expert, points out that when you open a shop on the street, both customers and shoplifters can enter. “You can't have one without the other,” he says. “It's the same on the Internet.” And as music, movies, tax returns, photographs and phone calls now routinely whizz around in digital form, the shift from traditional to digital formats has reached a critical point, says Whitfield Diffie, a security guru at Sun Microsystems: “We can no longer continue this migration without

basic security.”

The September 11th attacks, then, reinforced an existing trend. Government officials, led by Richard Clarke, America's cyber-security tsar, gave warning of the possibility that terrorists might mount an “electronic Pearl Harbour” attack, breaking into the systems that control critical telecommunications, electricity and utility infrastructure, and paralysing America from afar with a few clicks of a mouse. Most security experts are sceptical, but after spending years trying to get people to take security seriously, they are willing to play along. Scott Charney, a former chief of computer crime at the Department of Justice and now Microsoft's chief security strategist, says Mr Clarke's scare-mongering is “not always helpful, but he has raised awareness.”

The terrorist attacks certainly prompted companies to acknowledge their dependence on (and the vulnerability of) their networks, and emphasised the importance of disaster-recovery and back-up systems. A survey of information-technology managers and chief information officers, carried out by Morgan Stanley after the attacks, found that security software had jumped from fifth priority or lower to become their first priority. “It's moved up to the top of the list,” says Tony Scott, chief technology officer at General Motors. “It's on everybody's radar now.”

The growing emphasis on security over the past year or two has been driven by a combination of factors, and has shown up in a variety of ways. Chris Byrnes, an analyst at Meta Group, a consultancy, notes that the proportion of his firm's clients (mostly large multinational companies) with dedicated computer-security teams has risen from 20% to 40% in the past two years. He expects the figure to reach 60-70% within the next two years. Previously, he says, it was financial-services firms that were most serious about security, but now firms in manufacturing, retailing and other areas are following suit.

One important factor is regulation. Mr Byrnes points to the change made to American audit standards in 1999, requiring companies to ensure that information used to prepare public accounts is adequately secured. This has been widely interpreted, with the backing of the White House's critical-infrastructure assurance office, to mean that a company's entire network must be secure.

Similarly, the April 2003 deadline for protecting patients' medical information under the Health Insurance Portability and Accountability Act (HIPAA) has prompted health-care providers, pharmaceutical companies and insurers to re-evaluate and overhaul the security of their computers and networks. In one recent case, Eli Lilly, a drug maker, was accused of violating its own online privacy policy after it accidentally revealed the e-mail addresses of 669 patients who were taking Prozac, an anti-depressant. The company settled out of court with America's Federal Trade Commission and agreed to improve its security procedures. But once HIPAA's privacy regulations come into force, companies that fail to meet regulatory standards will face stiff financial penalties. The same sort of thing is happening in financial services, where security is being beefed up prior to the introduction of the Basel II bank-capital regulations.

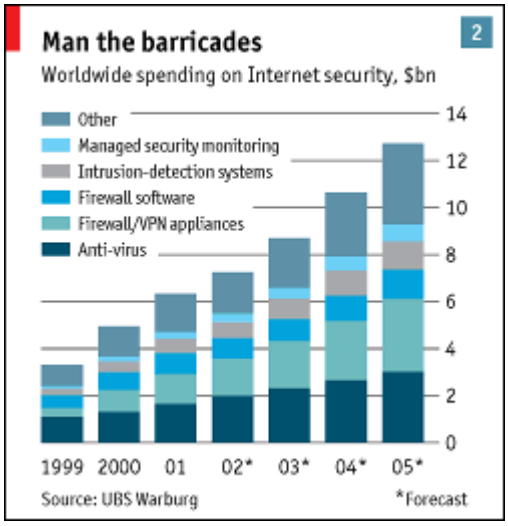
The growth of high-profile security breaches has also underlined the need to improve security. The number of incidents reported to Carnegie Mellon's computer emergency response team (CERT), including virus outbreaks and unauthorised system intrusions, has shot up in recent years (see chart 1) as the Internet has grown. The “Love Bug”, a virus that spreads by e-mailing copies of itself to everyone in an infected computer's address book, was front-page news when it struck in May 2000. Many companies, and even Britain's Parliament, shut down their mail servers to prevent it from spreading.

There have been a number of increasingly potent viruses since then, including Sircam, Code Red and Nimda, all of which affected hundreds of thousands of machines. The latest, called Bugbear, struck only this month. Viruses are merely one of the more visible kinds of security problem, but given the disruption they can cause, and the widespread media coverage they generate, such outbreaks prompt people to take security more seriously.

## Fear, sex and coffee

Spending on security technology grew by 28% in 2001 compared with the year before, according to Jordan Klein, an analyst at UBS Warburg. Mr Klein predicts that spending will continue to grow strongly over the next few years, from around $6 billion in 2001 to $13 billion in 2005 (see chart 2). A survey carried out by Meta Group in August found that although only 24% of firms had increased their technology budgets in 2002, 73% had increased their spending on security, so security spending is growing at the expense of other technology spending. This makes it a rare bright spot amid the gloom in the technology industry.

Steven Hofmeyr of Company 51, a security start-up based in Silicon Valley, says his company is pushing at a wide-open door: there is no need to convince anyone of the need for security technology. Indeed, Nick Sturiale of Sevin Rosen, a venture-capital fund, suggests that security is already an overcrowded and overfunded sector. “Security is now the Pavlovian word that draws the drool from VCs' mouths,” he says. Security vendors are really selling fear, he says, and fear and sex are “the two great sales pitches that make people buy irrationally”.




So, a bonanza for security-technology firms? Not necessarily. The sudden interest in security does not always translate into support from senior management and larger budgets. A recent report from Vista Research, a consultancy, predicts that: “While the need to protect digital assets is well established, companies will pay lip service to the need to invest in this area and then largely drag their feet when it comes to capital spending on security.”

Even where security spending is increasing, it is from a very low base. Meta Group's survey found that most companies spend less than 3% of their technology budgets on security. Technology budgets, in turn, are typically set at around 3% of revenues. Since 3% of 3% is 0.09%, most firms spend more on coffee than on computer security, according to a popular industry statistic. The purse strings loosen only when companies suffer a serious security breach themselves, see one of their rivals come under attack or are told by auditors that lax security could mean they are compromising due diligence.

## Jobs on plates

Mr Byrnes notes another factor that is impeding growth of the security market: a shortage of senior specialists. For much of the past year, he says, “There was more security budget than ability to spend it.” John Schwarz, president of Symantec, a security firm, puts the number of unfilled security jobs at 75,000 in America alone. As a result, the security boom widely expected last year has yet to materialise. But Mr Hofmeyr reckons that the increase in security spending is just starting to kick in.

Given the new interest in security, established technology firms, which have seen revenues plunge as firms slash technology spending in other areas, are understandably keen to jump on the bandwagon alongside specialist security vendors. Sun's advertisements boast: “We make the net secure.” Oracle, the world's second-largest software firm, has launched a high-profile campaign trumpeting (to guffaws from security experts) that its database software is “unbreakable”. Whether or not this is true, Oracle clearly regards security as a convenient stick with which to bash its larger arch-rival, Microsoft, whose products are notoriously insecure—hence Mr Gates's memo.

It suits vendors to present security as a technological problem that can be easily fixed with more technology—preferably theirs. But expecting fancy technology alone to solve the problem is just one of three dangerous misconceptions about digital security. Improving security means implementing appropriate policies, removing perverse incentives and managing risks, not just buying clever hardware and software. There are no quick fixes. This survey will argue that digital security depends as much—if not more—on human cultural factors as it does on technology. Implementing security is a management as well as a technical problem. Technology is necessary, but not sufficient.

A second, related misperception is that security can be left to the specialists in the systems department. It cannot. It requires the co-operation and support of senior management. Deciding which assets need the most protection, and determining the appropriate balance between cost and risk, are strategic decisions that only senior management should make. Furthermore, security almost inevitably involves inconvenience. Without a clear signal from upstairs, users will tend to regard security measures as

nuisances that prevent them from doing their jobs, and find ways to get around them.

Unfortunately, says Mr Charney, senior executives often find computer security too complex. “Fire they understand,” he says, because they have direct personal experience of it and know that you have to buy insurance and install sensors and sprinklers. Computer security is different. Senior executives do not understand the threats or the technologies. “It seems magical to them,” says Mr Charney. Worse, it's a moving target, making budgeting difficult.

A third common misperception concerns the nature of the threat. Even senior managers who are aware of the problem tend to worry about the wrong things, such as virus outbreaks and malicious hackers. They overlook the bigger problems associated with internal security, disgruntled ex-employees, network links to supposedly trustworthy customers and suppliers, theft of laptop or handheld computers and insecure wireless access points set up by employees. That is not surprising: viruses and hackers tend to get a lot of publicity, whereas internal security breaches are hushed up and the threats associated with new technologies are often overlooked. But it sets the wrong priorities.

## Detective stories

A final, minor, misperception is that computer security is terribly boring. In fact, it turns out to be one of the more interesting aspects of the technology industry. The war stories told by security consultants and computer-crime specialists are far more riveting than discussion of the pros and cons of customer-relationship management systems. So there really is no excuse for avoiding the subject.

Anyone who has not done so already should take an interest in computer security. Unfortunately there is no single right answer to the problem. What is appropriate for a bank, for example, would be overkill for a small company. Technology is merely part of the answer, but it has an important role to play, so that is where this survey will start.

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# Tools of the trade

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**How a box of technological tricks can improve (but not guarantee) your security**

ASK a non-specialist about computer security, and he will probably mention viruses and attacks by malicious hackers, if only because they are so much more visible than other security problems. Take viruses first. Like their biological counterparts, computer viruses are nasty strings of code that exploit their hosts to replicate themselves and cause trouble. Until a few years ago, viruses merely infected files on a single computer. Eventually, an infected file would be moved, typically on a floppy disk, to another machine where the virus could spread. Modern viruses, however, are far more insidious, because they can jump from one computer to another across the Internet, most often by e-mail. (Since self-propagating programs are technically known as worms, such viruses are sometimes called worm-virus hybrids.)

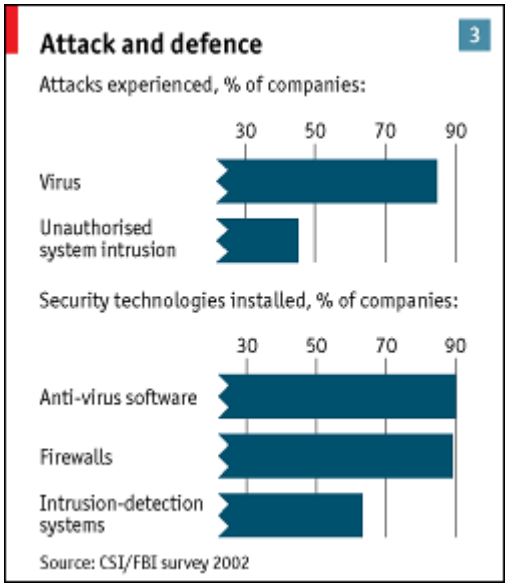
Recent high-profile examples include Sircam, which struck in July 2001 and generated much comment because as well as e-mailing copies of itself to everyone in an infected PC's address book, like previous viruses, it also enclosed random documents from the infected machine's hard disk with each message. Users thus unwittingly sent half-finished screenplays, unsent letters and private diary jottings to their friends, sometimes with embarrassing results. Code Red, which also struck that month, was a worm that exploited a security vulnerability in Microsoft's web-server software to spread from one server to another. Infected servers were programmed to flood the White House website with traffic for a week.

## Patching it up

The weakness that Code Red exploited had been discovered in June, and Microsoft had issued a software “patch” to correct it. But software patches are issued all the time, and keeping up with new patches and deciding which to install is more than many system administrators can manage. Within a week of Code Red's appearance, 300,000 computers were infected with it. Sometimes it defaced infected web servers with the message “Hacked by Chinese!”, which suggested a political motivation, but the identities and motives of virus writers can rarely be determined for sure. Similarly, Nimda, a particularly vigorous virus/worm which struck on September 18th 2001, was initially assumed to have some connection with the previous week's terrorist attacks, though this now seems unlikely.

Viruses are extremely widespread, which is more than can be said for meaningful statistics about them. The annual survey carried out by the Computer Security Institute (CSI) in San Francisco, in conjunction with the Federal Bureau of Investigation's local computer-intrusion squad, is generally regarded as one of the more authoritative sources of information about computer security. According to the most recent CSI/FBI report, published in April 2002, 85% of respondents (mainly large American companies and government agencies) encountered computer viruses during 2001 (see chart 3). Quantifying the damage done by viruses, however, is extremely difficult. Certainly, cutting off e-mail or Internet connections can seriously hamper a company's ability to do business. In severe cases every single computer in an office or school may need to be disinfected, which can take days.

Yet assigning costs to outbreaks is guesswork at best. Computer Economics, a consultancy, puts the worldwide costs imposed by viruses in 2001 at $13.2 billion. But few outside the marketing departments of anti-virus-software vendors take such figures seriously. Critics point out that if most companies are themselves unable to quantify the cost of cleaning up viruses in their systems, it is hard to see how anyone else can. Far easier to quantify is the surge in sales of anti-virus software that follows each outbreak. Following the Code Red and Nimda strikes, for example, anti-virus sales at Symantec, a leading security-software firm, in the last quarter of 2001 were 53% up on a year earlier.




Anti-virus software works by scanning files, e-mail messages and network traffic for the distinguishing characteristics, or "signatures", of known viruses. There is no general way to distinguish a virus from a non-malicious piece of code. Both are, after all, just computer programs, and whether a particular program is malicious or not is often a matter of opinion. So it is only after a virus has infected its first victims and has started to spread that its signature can be determined by human analysts, and that other machines can be inoculated against it by having their database of signatures updated. Inevitably, the result is an arms race between the mysterious folk who write viruses (largely for fun, it seems, and to win the kudos of their peers) and makers of anti-virus software. Some viruses, including a recent one called Klez, even attempt to disable anti-virus software on machines they infect, or spread by posing as anti-virus updates.

Viruses are a nuisance, but the coverage they receive is disproportionate to the danger they pose. Some vendors of anti-virus software, particularly the smaller ones, fuel the hysteria by sending out jargon-filled warnings by e-mail at every opportunity. From a technical point of view, protecting a computer or network against viruses is tedious but relatively simple, however: it involves installing anti-virus software on individual machines and keeping it up to date. Virus-scanning software that sits on mail servers and scans e-mail messages before they are delivered can provide an extra defensive layer.

Dealing with intrusions by malicious hackers is an altogether more complex problem. (The word "hacker" merely means a clever programmer, but is commonly applied to those who use their skills to malicious ends.) Computers are such complex systems that there are endless ways for unauthorised users to attempt to gain access. Attackers very often use the same security flaws that worms and viruses exploit; such worms and viruses can be seen as an automated form of malicious hacking.

Having gained access to a machine, an attacker can deface web pages (if the machine is a web server), copy information (if the machine stores user information, financial data or other documents), use the machine as a base from which to attack other machines, or install "Trojan horse" software to provide easy access in future or to enable the machine to be remotely controlled over the Internet. Savvy attackers cover their tracks using special software known as a "root kit", which conceals the evidence of their activities and makes unauthorised use difficult to detect.

As with viruses, meaningful figures for unauthorised intrusions are hard to find. Many attacks go unnoticed or unreported. But the CSI/FBI survey gives some flavour of the scale of the problem. Of the 503 large companies and government agencies that participated in the survey, 40% detected system intrusions during 2001, and 20% reported theft of proprietary information. Of the companies that were attacked, 70% reported vandalism of their websites. But it is dangerous to lump all attacks together. Just as there is a difference between a graffiti-spraying youth and a criminal mastermind, there is a world of difference between vandalising a web page and large-scale financial fraud or theft of intellectual property.

The principal tool for keeping unwanted intruders out of computers or networks is the firewall. As its name suggests, a firewall is a device that sits between one network (typically the Internet) and another (such as a closed corporate network), enforcing a set of rules about what can travel to and fro. For example, web pages might be allowed inside the firewall, but files might not be allowed to go outside.

## Walls have ears

Firewalls are no panacea, however, and may give users a false sense of security. To be effective, they

must be properly configured, and must be regularly updated as new threats and vulnerabilities are discovered. “What kind of firewall you have matters far less than how you configure it,” says Bill Murray of TruSecure, a security consultancy. There are dozens of competing firewall products on the market, but most of them come in two main forms: as software, which can be installed on a machine to regulate traffic, and as hardware, in the form of appliances that plug in between two networks and regulate the flow of traffic between them.

The leader in the field, with 40% of the market, is Check Point Software of Ramat Gan, Israel. Four years ago, says Jerry Ungerman, Check Point's president, people thought the firewall market was almost saturated, because most firms had one, but the market has continued to grow. The notion that each company simply needs one firewall, between its internal network and the Internet, is now outmoded. Companies often have many separate links to the Internet, want to wall off parts of their internal networks from each other, or choose to install firewall software on every server. Some of Check Point's clients, says Mr Ungerman, have over 1,000 firewalls installed. The advent of fixed broadband connections means that home users, who often leave their computers switched on around the clock, now need firewalls too if they are to protect their machines from intruders. Even mobile phones and hand-held computers, he predicts, will have firewalls built into them.

Firewalls have their uses, but there are many kinds of attacks they cannot prevent. An attacker may be able to bypass the firewall, or exploit a vulnerability by sending traffic that the firewall regards as legitimate. Many attacks involve sending artfully formulated requests to web servers, causing them to do things that would not normally be allowed, says Geoff Davies of i-Sec, a British security consultancy. To show how easily this can be done, he types a string of database commands into the search field of an online travel agent, and instead of a table of flight departures and arrivals, the website comes up with a table of information about its users. (Mr Davies carried out this demonstration, called an “SQL insertion” attack, on a dummy server specially set up for the purpose, but it is a widespread vulnerability on real websites.) To a firewall, such an attack may look just like a legitimate use of the web server.

## Halt! Who goes there?

An alternative is the “intrusion-detection system” (IDS), which monitors patterns of behaviour on a network or an individual computer and sounds an alarm if something looks fishy. Some kinds of detection systems monitor network traffic, looking for unusual activity, such as messages passing to and from a Trojan horse on the network; others sit on computers, looking for unusual patterns of access, such as attempts to retrieve password files.

Compared with anti-virus software and firewalls, detection is a relatively immature technology, and many people believe it is more trouble than it is worth. The difficulty is tuning an IDS correctly, so that it spots mischievous behaviour reliably without sounding too many false alarms. An IDS may end up like the boy who cried wolf—when a genuine attack occurs after too many false alarms, nobody pays any attention. And even when it is properly tuned, people may not know how to stop the problem when an IDS sounds the alarm. All too often the response is, “We just got hacked—what do we do?”, says Chris King of Meta Group.

Other tools in the security toolbox include encryption, the mathematical scrambling of data so that only the intended recipient can read them, and the related technique of cryptographic authentication to verify that people are who they claim they are. These tools can be integrated into an e-mail system, for example, using encryption to ensure that messages cannot be read in transit, and authentication to ensure that each message really did come from its apparent sender. The same techniques can also be used to send information (such as credit-card details) to and from websites securely.

Another popular use of encryption and authentication is the “virtual private network” (VPN), which allows authenticated users to establish secure communications channels over the Internet to a closed network. VPNs are widely used to knit a company's networks in different parts of the world together securely across the Internet, and to allow travelling employees to gain secure access to the company network from wherever they are.

There is still plenty of room for innovation in security technology, and there are dozens of start-ups working in the field. Company 51 of San Mateo, California, has devised an “intrusion-prevention system”, based on the workings of the human immune system. When an attack is detected, the attacker is promptly disconnected. Cenzic, also based in Silicon Valley, has devised a novel approach to security testing called “fault injection”. Greg Hoglund, the company's co-founder, says most testing of security

software is akin to testing a car by driving it on a straight, flat road. Just as cars are crash-tested, Cenzic's software, called Hailstorm, stress-tests software by bombarding it with attacks.

## Blame it on the bugs

A typical network, then, is secured using a multi-layered combination of security technologies. But these fancy measures merely treat the effects of poor security. A parallel effort is being made to deal with one of its main causes: badly written software. According to @Stake, a security consultancy based in Cambridge, Massachusetts, 70% of security defects are due to flaws in software design. Code Red, for example, exploited a “bug”, or coding error, in the way Microsoft's web-server software handles non-Roman characters. Buggy software tends to be insecure. So by taking a firmer stand against bugs and making their programs more reliable, software firms can also improve security.

Microsoft is now making a particular effort to improve its reputation for shoddy security. New bugs and vulnerabilities in its products are found weekly. This does not necessarily mean that Microsoft's software is particularly badly written, but has much to do with its ubiquity. Microsoft has a monopoly in desktop operating systems, after all, and a near-monopoly in web browsers and office productivity software. Find a hole in Internet Explorer, Microsoft's web browser, for example, and you are capable of attacking the vast majority of the world's PCs. Find a hole in Netscape's rival web browser, which is far less widely used, and you will be able to attack fewer than 10% of them.

Now that the threat to Microsoft of dismemberment by America's Department of Justice has receded, the company's poor reputation in security looks like its single biggest problem. Last year, following the Code Red and Nimda outbreaks, both of which exploited security flaws in Microsoft products, John Pescatore at Gartner, an influential consultancy firm, suggested that companies that wanted to avoid further security problems should stop using Microsoft's software. Bill Gates responded by issuing his company-wide memo in January on “trustworthy computing”.

Microsoft is pulling out all the stops to reduce the number of security vulnerabilities in its products. “There was a sea change in the way our customers were thinking,” says Pierre de Vries, Microsoft's director of advanced product development. The company, he says, realised that it had “a real problem” even before Mr Pescatore's report. Earlier this year, the 8,500 programmers in the company's Windows division were given new security training, after which they spent two months combing their code for potential vulnerabilities. New tools devised by the company's research division, called “Prefix” and “Prefast”, are used to scan for possible problems. And when coding errors are found, they are not only fixed but an effort is now made to find out how they slipped through the net in the first place.

The work the programmers are doing now will not be reflected in the company's products for a year or two, but Microsoft has also tightened security in other ways. The latest version of its web-server software, for example, arrives with most options switched off by default. Customers have to decide which options they want to use, and make a conscious choice to switch them on. This reduces their exposure to problems in parts of the software they were not using anyway. But some customers complained about having to work out which options they did and did not need, says Mr de Vries. One of them even asked for a button to turn everything on. The cost of improved security, it seems, is often a reduction in convenience.

This kind of thing goes against the grain for Microsoft. Traditionally, its products have had all the bells and whistles (such as the infamous talking paper clip - see article) turned on by default, to make it more likely that users will discover and use new features. Microsoft is also renowned for encouraging users to upgrade for extra features. But priorities have changed. As Mr Gates wrote to his workforce, “When we face a choice between adding features and resolving security issues, we need to choose security.”

Microsoft's policy of tight integration between its products, which both enhances ease of use and discourages the use of rival software makers' products, also conflicts with the need for security. Because Microsoft's programs are all linked, a flaw in one of them can be used to gain access to others. Many viruses, for example, exploit holes in Microsoft's mail or browser software to infect the underlying Windows operating system.

Many observers believe that Microsoft's new-found concern over security is mere window-dressing. The Windows operating system is the largest piece of software ever written, so implementing security retrospectively is a daunting task. Mary Ann Davidson, chief security officer at Oracle, contends that American federal agencies are “really angry” with Microsoft over the insecurity of its products. Oracle,

whose flagship database software grew out of a consulting contract for the Central Intelligence Agency, has many black-suited “professional paranoids” among its customers, so the company has security awareness far more deeply ingrained in its corporate culture, she says. But what of Oracle's advertising claims that its own software is “unbreakable”? Perfect security is impossible, she concedes; the campaign “is about being fanatical about security.”

## Need to know

A key test of a company's commitment to security is the speed with which it responds to vulnerabilities. The difficulty, says Steve Lipner, Microsoft's director of security assurance, is that when a new vulnerability is discovered, customers want a patch immediately, but they also want the patch to be properly tested, which takes time. Furthermore, issuing a separate patch for every vulnerability makes life harder for systems administrators, so Microsoft now prefers to group several patches together. But that lays it open to the charge that it is not responding fast enough. Once a vulnerability has been announced, attackers will start trying to exploit it immediately. According to Mr Davies, some big websites get attacked as little as 40 minutes after the publication of a new vulnerability. But the patch may not be available for weeks.

Mr Lipner says he would prefer researchers who find flaws to report them to Microsoft, but not to publicise them until a patch is available. The trouble is that software makers have little incentive to fix patches that nobody knows about, so many security researchers advocate making vulnerabilities public as soon as they are found. Admittedly, this alerts potential attackers, but they may already have known about them anyway. Proponents of this “full disclosure” approach argue that its benefits outweigh the risks. “Sunlight is the best disinfectant,” says Mr Diffie at Sun Microsystems.

Will software makers ever come up with products that are free of security vulnerabilities? It seems very unlikely, but even if they did, there would still be plenty of systems that remained unpatched or incorrectly configured, and thus vulnerable to attack. No matter how clever the technology, there is always scope for human error. Security is like a chain, and the weakest link is usually a human.

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# The weakest link

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**If only computer security did not have to involve people**

THE stereotype of the malicious hacker is a pale-skinned young man, hunched over a keyboard in a darkened room, who prefers the company of computers to that of people. But the most successful attackers are garrulous types who can talk their way into, and out of, almost any situation. In the words of Mr Schneier, the security guru, “Amateurs hack systems, professionals hack people.”

Kevin Mitnick, perhaps the most notorious hacker of recent years, relied heavily on human vulnerabilities to get into the computer systems of American government agencies and technology companies including Fujitsu, Motorola and Sun Microsystems. Testifying before a Senate panel on government computer security in 2000, after spending nearly five years in jail, Mr Mitnick explained that:

> When I would try to get into these systems, the first line of attack would be what I call a social engineering attack, which really means trying to manipulate somebody over the phone through deception. I was so successful in that line of attack that I rarely had to go towards a technical attack. The human side of computer security is easily exploited and constantly overlooked. Companies spend millions of dollars on firewalls, encryption and secure access devices, and it's money wasted, because none of these measures address the weakest link in the security chain.

Human failings, in other words, can undermine even the cleverest security measures. In one survey, carried out by PentaSafe Security, two-thirds of commuters at London's Victoria Station were happy to reveal their computer password in return for a ballpoint pen. Another survey found that nearly half of British office workers used their own name, the name of a family member or that of a pet as their password. Other common failings include writing passwords down on sticky notes attached to the computer's monitor, or on whiteboards nearby; leaving machines logged on while out at lunch; and leaving laptop computers containing confidential information unsecured in public places.

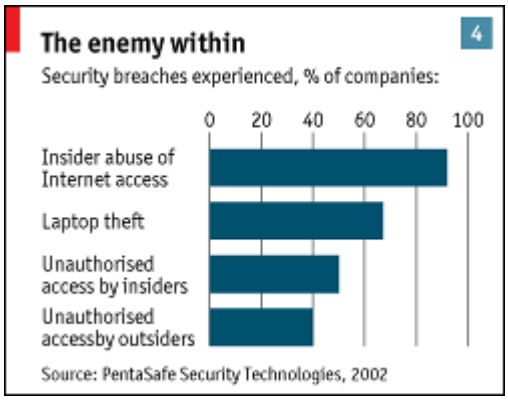
Unless they avoid such elementary mistakes, a firm's own employees may pose the largest single risk to security. Not even technical staff who should know better are immune to social engineering. According to Meta Group, the most common way for intruders to gain access to company systems is not technical, but simply involves finding out the full name and username of an employee (easily deduced from an e-mail message), calling the help desk posing as that employee, and pretending to have forgotten the password.

Simple measures, such as encouraging employees to log out during lunch hours and to choose sensible passwords, can dramatically enhance security at very little cost. Passwords should be at least six and ideally eight characters long, and contain a mixture of numbers, letters and punctuation marks. Dictionary words and personal information should not be used as passwords. Users should have a different password on each system, and they should never reveal their passwords to anyone, including systems managers.

Yet a seminal paper published as long ago as 1979 by Ken Thomson and Robert Morris found that nearly a fifth of users chose passwords consisting of no more than three characters, and that a third used dictionary words. (Robert Morris, the chief scientist at America's National Computer Security Centre, was subsequently upstaged by his son, also called Robert, who released the first Internet worm in 1988 and

crashed thousands of computers. Ironically, the worm exploited badly chosen passwords.) But back in 1979, only a small fraction of a typical company's workforce used computers on a daily basis. Now that almost everybody uses them, the potential for trouble is much greater.

A few precautions also go a long way when it comes to stopping the spread of viruses. Many viruses travel inside e-mail messages, but require the user to double-click them in order to start propagating. So they pose as games, utilities, anti-virus updates or even as nude photographs of well-known tennis players. The curious user double-clicks, nothing seems to happen, and the user thinks no more about it, but the virus has started to spread. Educating users not to double-click on dubious attachments is a simple but effective counter-measure against viruses.




If correctly handled, a management-based, rather than a solely technology-based, approach to security can be highly cost-effective. The danger, says Peter Horst of TruSecure, is that: “People buy a hunk of shining technology, wipe their brow and say, ‘Great, I've taken care of it,' when they might have been better off saving money and doing something simple in terms of policy and process.” Probably the best example of how expensive, glamorous security technology can easily be undermined by poor procedures is biometric systems (see article).

A sensible and balanced approach, then, involves not only security technology but also a well-defined set of security policies which users understand and keep to. This approach is promoted by the Human Firewall Council, a group which argues that users themselves have an important role to play in maintaining security. Steve Kahan, its president, draws an analogy with neighbourhood-watch schemes. The idea, he says, is “to make security everyone's business”, and to have a clear security policy that governs what is and is not allowed. That policy should then be implemented both by guiding the behaviour of users and by the appropriate configuration of firewalls, anti-virus software and so forth, in much the same way that a combination of neighbourly vigilance, alarms and door locks is used to combat burglars in the real world. But, says Mr Kahan, surveys show that half of all office workers never receive any security training at all.

One way to disseminate and enforce security policy is to add yet another layer of security software, as demonstrated by PentaSafe Security, one of the backers of the Human Firewall Council. Its software can ensure that users are familiar with a company's security policy by popping messages and quiz-like questions up on the screen when they log on. According to PentaSafe's figures, 73% of companies never require employees to re-read security policies after they begin their employment, and two-thirds of companies do not track whether their employees have read the policy in the first place.

David Spinks, European director of security at EDS, a computer-services firm, says all EDS employees have to take a regular on-screen test to ensure they understand the company's policy on passwords, viruses and network security. Choice of technology, he says, matters far less than managing both technology and users properly: “The key to having a firewall isn't the firewall, but how the policies are set, monitored, managed and kept up to date.” Two companies can use exactly the same product, he notes, and one can be secure while the other is insecure. It is effective management that makes the difference.

## The dismal science of security

But there are other, more subtle ways in which management and security interact. “More than anything else, information security is about work flow,” says Ross Anderson of Cambridge University's Computer Laboratory. The way to improve security, he says, is to think about people and processes rather than to buy a shiny new box. Mr Anderson is one of a growing number of computer scientists who are applying ideas from economic theory to information security. Insecurity, he says, “is often due to perverse incentives, rather than to the lack of suitable technical protection mechanisms.” The person or company best placed to protect a system may, for example, be insufficiently motivated to do so, because the costs of failure fall on others. Such problems, Mr Anderson argues, are best examined using economic concepts, such as externalities, asymmetric information, adverse selection and moral hazard.

A classic example is that of fraud involving cash dispensers (automated teller machines). Mr Anderson

investigated a number of cases of “phantom withdrawals”, which customers said they never made, at British banks. He concluded that almost every time the security technology was working correctly, and that misconfiguration or mismanagement of the machines by the banks was to blame for the error. In Britain, it is customers, not banks, that are liable when phantom withdrawals are made, so the banks had little incentive to improve matters. In America, by contrast, it is the banks that are liable, so they have more of an incentive to train staff properly and install additional anti-fraud measures, such as cameras.

Similar examples abound on the Internet. Suppose an attacker breaks into company A's computers and uses them to overload company B's computers with bogus traffic, thus keeping out legitimate users. Company B has suffered, in part, because of the insecurity of company A's systems. But short of a lawsuit from company B, company A has no incentive to fix the problem. Some examples of this sort of thing have already started to appear. In one case, a Texas judge issued a restraining order against three companies whose computers were being used by intruders to attack another firm's systems. The three companies were forced to disconnect from the Internet until they could demonstrate that the vulnerabilities exploited by the attackers had been fixed.

Economic and legal measures will, predicts Mr Schneier, play an increasing role in compensating for perverse incentives that foster insecurity. Just as chief financial officers are legally required to sign statements declaring that company accounts are accurate, he speculates that, at least in certain industries, chief security officers might eventually have to sign security declarations. Similarly, product-liability lawsuits against software companies whose products are insecure would almost certainly discourage software makers from cutting corners on security.

## The enemy within

Incompetence and indifference are one thing; misconduct is another. Although external attacks get more attention in the media, notes a recent report from Vista Research, a consultancy, “the bulk of computer-security-related crime remains internal.” Mr Anderson puts it a different way: the threat of hackers, he says, is “something that the security manager waves in your face to get the budget to deal with internal fraud.” Vista estimates that 70% of security breaches that involve losses above $100,000 are perpetrated internally, often by disgruntled employees.

Attacks by insiders are potentially far costlier than external ones. The CSI/FBI survey, albeit using a small sample size, found that an insider attack against a large company caused an average of $2.7m-worth of damage, whereas the average external attack cost $57,000. A survey carried out by Oracle found that British companies believe malicious attacks by insiders pose more of a threat than external ones.

Defences against external attacks may not be much use against insiders. For a start, such people are likely to be inside the firewall (although companies are increasingly using internal firewalls between departments). And to an intrusion-detection system, an insider attack looks very different from an external one; by one estimate, an IDS has less than a 40% chance of distinguishing an insider attack from legitimate use of the network. One option is to use an analysis and visualisation tool, such as that made by SilentRunner. It represents network activity graphically to help security staff spot unusual behaviour—perhaps a large number of file transfers in a department where lay-offs have just been announced.

An alternative approach when fraud is suspected is to use “honeypots”—decoy servers that lure attackers and collect evidence so that people who are up to no good can be identified. In one case cited by Recourse Technologies, a security firm that is now part of Symantec, a large financial firm discovered that its payroll systems had been compromised. Two dozen honeypots were set up, with names such as “payroll server”, which caught the company's chief operating officer as he was trying to manipulate another executive's payroll record. He confessed to attempted fraud and resigned.

But the difficulty of combating insider attacks with technical means demonstrates that security is mainly a people problem. Indeed, the root cause of an insider attack may be poor management. An employee may resent being demoted or passed over for promotion, or feel underpaid or undervalued. Better management is a far more promising way to deal with these kinds of problems than technology.

The best way to prevent criminal activity by insiders is to make it difficult. “One of the key things you need is a separation of duties, so that no one individual runs everything,” says Mr Spinks. Another simple measure is to ensure that all employees go on holiday at some point, to prevent them from maintaining

tainted systems or procedures. Access privileges to company systems need to match employees' job descriptions so that, for example, only people in the personnel department can access employee records. When employees leave the company or their roles change, their access privileges must be revoked or altered immediately. And clear rules are needed to make sure that security staff know what to do if they detect abuse by senior managers. Better internal security procedures to deal with malicious insiders should also help to protect against external attacks, says Bill Murray of TruSecure.

One of the biggest threats to security, however, may be technological progress itself, as organisations embrace new technologies without taking the associated risks into account. To maintain and improve security, you need more than just the right blend of technology, policy and procedure. You also need to keep your eye on the ball as new technologies and new threats emerge.

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# Biometric fact and fiction

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**Body-scanning technology has its drawbacks**

YOU'VE seen them in spy films and science-fiction movies: eye-scanners, fingerprint readers, facial-recognition systems. Such body-scanning or “biometric” systems, which can make sure that somebody really is who he claims to be, are touted as the ultimate in security technology. Systems protected by passwords are unlocked by something you know (the password), which others can find out. Systems protected by keys or their high-tech equivalents, smart cards, are unlocked by something you have (the key), which others can steal. But systems protected by biometrics can be unlocked only by a bodily characteristic (such as a fingerprint) that no one can take from you. Your body is your password.

Eye-scanning biometric technology played a prominent part in a recent science-fiction movie, “Minority Report”. Its star, Tom Cruise, played a policeman accused of a crime who goes on the run. In the movie's futuristic setting, eye scanners are used to ensure that only legitimate users can access computer systems. Mr Cruise's character has eye transplants to conceal his identity, but also keeps his old eyeballs so that he can continue to log on to the police network.

That excursion into a fictional future highlights two real problems. The first is that the technology is not as secure as its proponents claim. Scanners that read fingerprints, the most widely used form of biometrics, proved easy to defeat in experiments carried out by Tsutomu Matsumoto, a security researcher at Yokohama National University. Mr Matsumoto was able to fool them around 80% of the time using fingers made of moulded gelatin. He was also able to take a photograph of a latent fingerprint (from a wine glass, for example) and use it to make a gelatin finger that fooled scanners 80% of the time as well. One advantage of gelatin is that having got past the guards, an intruder can eat the evidence.

Facial recognition, in which a computer analyses images from a digital camera and compares them with a “watch list” of known faces, is unreliable too. A study carried out at America's Defence Department found that instead of the claimed 90% accuracy rate, such systems correctly identified people only 51% of the time. Since the September 11th attacks, the technology has been tested at a number of American airports, but in one trial it was found that face-scanners could be fooled by people who turned their heads slightly. Recalibrating the system to allow looser matches caused a flood of false positives (where someone is wrongly identified as being on the watch list).

Identix, a leading supplier of facial-recognition systems, claims that its equipment's accuracy rate can be as high as 99%. But Mr Schneier, the security expert, says that even with an accuracy rate of 99.99%, and assuming that one in 10m fliers is a suspect whose face is on the watch list, there will still be 1,000 false alarms for every suspect identified. And most terrorists are not on watch lists. Face-scanning may reassure people and may have a deterrent effect, but these meagre benefits do not justify the costs.

The second and more important problem is that biometric technology, even when it works, strengthens only one link in the security chain. Its effectiveness is easily undermined by failures of process or policy. Tom Cruise's character in “Minority Report” is still able to get into the police computer network while on the run because someone has neglected to revoke his access privileges. This simple failure of process is all too common in real life. Another such real-world failure involves the use of hand-geometry scanners in airports. Each person's hand is supposed to be scanned separately, but often the first person in a group goes through the door and then holds it open.

In short, biometrics are no panacea. The additional security they provide rarely justifies the cost. And in high-risk environments such as banks or jails, other measures are still needed.

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# When the door is always open

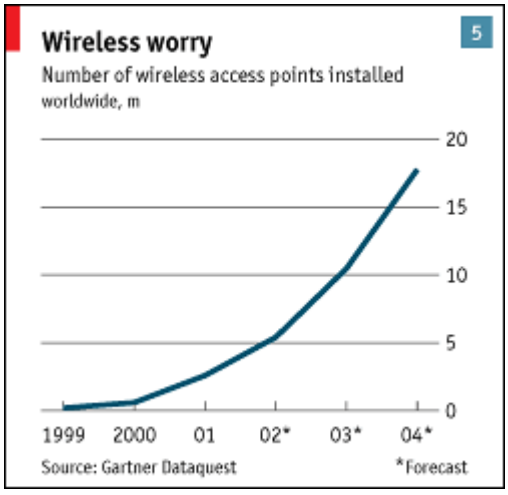
Oct 24th 2002
From The Economist print edition

**The more that companies open up and interconnect their networks, the bigger the risk of security problems**

NOT long ago, at the height of the dotcom boom, you could chart the rise and fall of companies by looking at the garish artwork sprayed on the walls of loft buildings in San Francisco's Multimedia Gulch district. But now, thanks to wireless technology, there is a better way. Driving around the city on a warm night a few weeks ago, Bill Cockayne, a Silicon Valley veteran, opens his car's sunroof. His friend Nathan Schmidt posts what looks like a small fluorescent tube through the open roof and plugs it into a laptop computer. “Metro/Risk”, says the computer in a clipped female voice as the car makes its way through North Beach. “Admin network. BCG.” Then a robotic male voice booms out: “Microsoft WLAN. Archangel. Whistler. Rongi.”

These are the names of computer networks in offices and homes that have been fitted with wireless access-points, which can provide Internet access to users within range (typically, within 100 metres or so). Mr Schmidt's computer is configured so that open access-points, which can often be used by anyone within range, have their names spoken by a female voice; closed ones, for which a password is required, are read out by a male voice. Most of them are open. Mr Cockayne pulls over, and Mr Schmidt connects to a nearby access-point and calls up *The Economist*'s web page.

This kind of wireless networking, using the so-called Wi-Fi protocol, has become immensely popular over the past two years, the technology crash notwithstanding (see chart 5). Many companies and individuals leave their access-points open deliberately to enable passers-by to share their Internet connections. Open a laptop in New York, San Francisco, Seattle or many other large cities around the world and you may well be able to get online free. But although Wi-Fi is liberating for users, it can cause security problems.




Adding an access-point to a network costs less than $200 and is very simple—so simple, in fact, that “rogue” access-points have started to sprout on corporate networks without the knowledge of management. A survey by *Computerworld*, an industry magazine, found that 30% of American companies had identified rogue access-points on their networks. And if these are left open, they provide a back door past the firewall into the company's network. Rob Clyde, chief technology officer at Symantec, says that half of the chief executives at a recent round-

table event cited Wi-Fi as a top security concern.

This is just one example of how a new technology can bring security problems in its wake. There are plenty of others. Some firms are opening up their networks through online business-to-business exchanges, for example, where they list what they want to buy or sell and invite bids. Everything from paper clips to car components is bought or sold in this way. There is widespread agreement that “web services”, in which companies open up their core business processes directly to other firms over the Internet, will become increasingly important in the next few years. But by opening its systems to outsiders, a company may also attract unwanted visitors, or attacks from nosy competitors.

Joint ventures, in which two firms collaborate and share information, can also cause problems. A recent report by Vista Research cites the example of an American car maker that established a joint venture with a Japanese firm and opened up its network to allow in employees of its Japanese partner. But the design of the American firm's network allowed access only on an “all or nothing” basis, so the Japanese firm's employees ended up with access to everything.

Handheld computers are another problem. They are often used to store sensitive data such as passwords, bank details and calendars. “The calendar is a fundamental loophole,” says Doug Dedo of Microsoft's mobile devices division, because it may contain entries such as “meeting with company X re merger”. Another problem associated with handheld computers is that their users carry them into the office and plug them into their computers, bypassing anti-virus systems and firewalls. A virus-infected document stored on a handheld computer could then start spreading. Similarly, peer-to-peer file-swapping networks such as Gnutella, instant-messaging services that zap messages and files across the Internet, and web-based e-mail systems such as Hotmail all provide new routes into a company's network that can be exploited by attackers.

There are plenty of technical fixes available. Handheld scanners can be used to track down rogue access-points, and legitimate access-points can be secured against outsiders by using virtual-private-network (VPN) software. A lot of work is being done to ensure that web services are secure, including, improbably, a joint initiative by rivals Microsoft and IBM. Anti-virus and firewall software exists for handheld computers, which can also be password-protected. And firewalls can be configured to prevent unauthorised use of peer-to-peer and instant-messaging services.

All these threats arise from a common factor: the distinction between the “public” parts of a company's network (such as the web servers where its home page resides) and the private core (which is accessible only to employees) is quickly eroding. “The cultural and technological trend is towards more porous companies,” says Gene Hodges, president of Network Associates, a large security-software firm. As firms connect with their suppliers and customers, “the more you open up, the more you are exposed.”

## Airports, not castles

The classic notion of perimeter security, in short, is fast becoming obsolete. Alan Henricks, chief executive of Cenzic, says the shift is “from keeping people out to bringing people in in a trusted fashion”. Nand Mulchandani, co-founder of Oblix, another security firm, puts it more colourfully: the “big walls, moat and crocodiles” approach of the past few years, he says, is now outdated.

The latest thinking is that rather than seeing their networks as castles, large organisations should regard them as airports. People go in and out all the time, some areas are more secure than others, and as people pass from one area to another they have to present their credentials: tickets, boarding passes or passports. Apply this approach to computer security, and instead of an “exclusive” model in which you try to prevent people from doing things they shouldn't, you have an “inclusive” model that lays down who can do what, and only lets certain people do certain things.

In the old days, says Tony Scott, chief technology officer at General Motors, computer systems were used only internally, and managing who was allowed to do what was simple. But with the recent proliferation of systems, and a greater reliance on suppliers and outsourcing, the number of users who may need access to a company's systems has grown rapidly. “On top of that, most modern companies now have their actual business processes deeply embedded in their systems,” he says. Indeed, their business processes are the systems. According to Mr Scott, “All these forces working together create a huge problem. Who is accessing these systems, and how can I manage it?”

One outfit offering solutions to this identity-management problem is Silicon-Valley-based Oblix. Its

software sits between users and a company's existing software systems (accounts, inventory, e-mail, and so on). Using a big database that includes information on who can do what, it makes sure that users can do only the things they are meant to do.

It sounds obvious, but it has two advantages: it means users need to log in only once, rather than into lots of separate systems; and it centralises and simplifies the management of user privileges. For example, a division manager who hires or fires an employee can instantly update that employee's access privileges, rather than having to ask the systems department to make changes to a number of separate systems.

Responsibility for security can thus be devolved to managers and form part of their everyday management duties. Management is all-important, says Mr Mulchandani, because if your eyeball reader correctly identifies a sacked employee but his access privileges have not been revoked, you have a security failure on your hands. Oblix's software is used by a number of large firms including General Motors, Boeing and Pfizer. Identity-management systems are also available from other vendors, including Novell, IBM and ActivCard, whose smart-card-based offering is used by America's armed forces. The technique does not do away with the need for traditional security measures, but it provides an additional line of defence, particularly for large organisations that have to deal with a lot of users.

More importantly, identity management is an example of how technology can be used to align security procedures with business processes. Security thus becomes the servant of management. Security decisions must ultimately be taken by managers, not technical staff. The big decision, and the most difficult to make, is how much time and money to spend on security in the first place.

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# Putting it all together

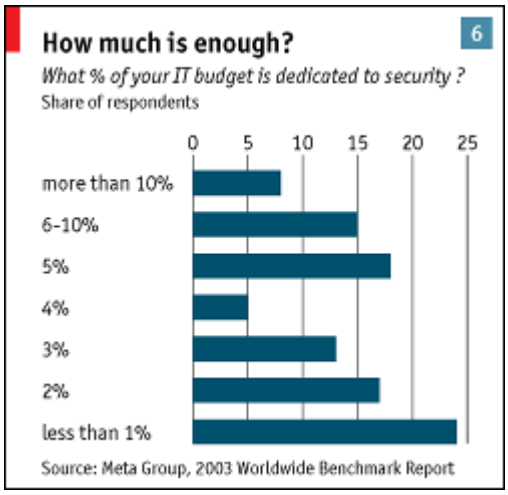
Oct 24th 2002
From The Economist print edition

**Security spending is a matter of balancing risks and benefits**

TOTAL computer security is impossible. No matter how much money you spend on fancy technology, how many training courses your staff attend or how many consultants you employ, you will still be vulnerable. Spending more, and spending wisely, can reduce your exposure, but it can never eliminate it altogether. So how much money and time does it make sense to spend on security? And what is the best way to spend them?

There are no simple answers. It is all a matter of striking an appropriate balance between cost and risk—and what is appropriate for one organisation might be wrong for another. Computer security, when you get down to it, is really about risk management. Before you can take any decisions about security spending, policy or management, the first thing you have to do is make a hard-headed risk assessment.

First, try to imagine all of the possible ways in which security could be breached. This is called “threat modelling”, and is more difficult than it seems. Mr Schneier, the security guru, illustrates this point by asking people to imagine trying to eat at a pancake restaurant without paying. The obvious options are to grab the pancakes and run, or to pay with a fake credit card or counterfeit cash. But a would-be thief could devise more creative attacks.




He could, for example, invent some story to persuade another customer who had already paid for his meal to leave, and then eat his pancakes. He could impersonate a cook, a waiter, a manager, a celebrity or even the restaurant owner, all of whom might be entitled to free pancakes. He might forge a coupon for free pancakes. Or he might set off the fire alarm and grab some pancakes amid the ensuing chaos. Clearly, keeping an eye on the pancakes and securing the restaurant's payment system is not enough. Threat modelling alerts you to the whole range of possible attacks.

The next step is to determine how much to worry about each kind of attack. This involves estimating the expected loss associated with it, and the expected number of incidents per year. Multiply the two together, and the result is the “annual loss expectancy”, which tells you how seriously to take the risk. Some incidents might cause massive losses, but be very rare; others will be more common, but involve smaller losses.

The final step is to work out the cost of defending against that attack. There are various ways to handle risk: mitigation (in the form of preventive technology and policies), outsourcing (passing the risk to someone else) and insurance (transferring the remaining risk to an insurer).

Suppose you are concerned about the risk of your website being attacked. You can mitigate that risk by installing a firewall. You can outsource it by paying a web-hosting firm to maintain the website on your behalf, including looking after security for you. And you can buy an insurance policy that, in the event of an attack, will pay for the cost of cleaning things up and compensate you for the loss of revenue. There are costs associated with each of these courses of action. To determine whether a particular security measure is appropriate, you have to compare the expected loss from each attack with the cost of the defence against it.

Firewalls make sense for large e-commerce websites, for example, because the cost of buying and maintaining a firewall is small compared with the revenue that would be lost if the site were shut down

by an intruder, however briefly. But installing biometric eye-scanners at every turnstile on a city's public-transport system would be overkill, because fare-dodging can be mitigated with far cheaper technology. By contrast, in high-security environments such as military facilities or intelligence organisations, where a security breach would have serious consequences, the use of expensive security technology may be justified. In some situations, however, the right response may be to do nothing at all.

## Standards stuff

That different organisations have different security needs is explicitly recognised in the ISO 17799, an international standard for “best practices in information security” that was introduced by the International Organisation for Standardisation in 2000. Risk analysis is a basic requirement of the standard, as is the establishment of a security policy. But, says Geoff Davies of i-Sec, a British security consultancy, “an industrial firm and a bank with ISO 17799 certification will have totally different systems.” The standard does not specify particular technological or procedural approaches to security, but concentrates on broadly defined ends rather than specific means.The standard's flexibility is controversial, however. Critics believe future versions of the standard should be more prescriptive and more specific about what constitutes “best practice”. Still, even in its current form, ISO 17799 is better than nothing. Many multinational companies have already embraced it to demonstrate their commitment to security. And in several Asian countries, companies that want to do business with the government electronically must conform to the standard.

Just as different organisations require different levels of protection, they will also respond to an attack in different ways. A large company, for example, may find it useful to have a dedicated security-response team. Scott Charney at Microsoft says that when an attack occurs, one of the things the team has to decide is whether to give priority to remediation or to investigation. Blocking the attack will alert the attacker, which may make collecting evidence against him difficult; but allowing the attacker to continue so that he can be identified may cause damage. Which is more appropriate depends on the context. In a military setting, tracking down the attacker is crucial; for a dotcom under attack by a teenager, blocking the attack makes more sense. Another difficult choice, says Mr Charney, is whether to bring in the police. Internal investigations allow an organisation to maintain control and keep things quiet, but law-enforcement agencies have broader powers.

For small and medium-sized companies, a sensible choice may be “managed security monitoring” (MSM). Firms that offer this service install “sentry” software and machines on clients' networks which relay a stream of messages to a central secure operations centre. Human operators watch for anomalous behaviour and raise the alarm if they detect anything suspicious. Using highly trained specialists to look out for trouble has the advantage that each operator can watch many networks at once, and can thus spot trends that would otherwise go unnoticed.

Risk analysis, and balancing cost and risk, is something the insurance industry has been doing for centuries. The industry is now showing increased interest in offering cover for computer-related risks. In the past, computer risks were included in general insurance policies, but were specifically excluded in the run-up to the year 2000 to avoid “millennium bug” liabilities. Now insurers are offering new products to protect companies against new risks. Because of the Internet, “the landscape has changed,” says David O'Neill, vice-president of e-Business Solutions at Zurich North America, which acts as a matchmaker between customers and underwriters. Greater connectivity means firms are now exposed to risks that were never contemplated by traditional insurance policies, he says.

Mr O'Neill can arrange insurance against a range of risks, including data theft, virus attacks or intrusions by malicious hackers, and loss of income owing to a security breach or network failure. Companies can also take out insurance against having to pay damages if confidential financial or medical data are accidentally or maliciously released. Because no two networks or businesses are alike, each policy is prepared individually.

Such cyber-insurance is, however, still very much in its infancy. The main problem is that the complexity of computer networks makes it very difficult to quantify risk accurately. By comparison, working out the likelihood that a 45-year-old smoker will have a heart attack in the next 12 months is a piece of cake. One reason for the lack of data, says Mr Charney, is that most security breaches are not detected or reported. But this will change. “When a company asks for $1m in damages after a virus outbreak, the insurer will say, ‘Prove it',” he explains. “Firms will have to substantiate it, and we will get some data.”

Mr Schneier predicts that insurance companies will start to specify what kinds of computer equipment

companies should use, or charge lower premiums to insure more secure operating systems or hardware. Already, firms that use the monitoring service provided by his company, Counterpane Internet Security, enjoy a 20-40% reduction in their premiums for cyber-insurance. But Mr Anderson at Cambridge University thinks the need for cyber-insurance is overblown. “Insurers are having a hard time, so they are turning e-risks into a new pot of gold,” he says.

## Wrong department

Most organisations already have the expertise required to handle computer security in a sensible way. Usually, however, this risk-management expertise is found not in the systems department but in the finance department. “Chief information officers, chief financial officers and other executives already know how to do risk analysis,” says Mr Davies. The systems department, on the other hand, does not; instead, it tends to be seduced by siren songs about technological fixes.

This survey has consistently argued that enthusiasm for technological solutions can go too far. In two areas in particular, security technology could end up doing more harm than good. First, some measures introduced in the name of improving security may have the side-effect of needlessly infringing civil liberties. Face-scanning systems at airports are a good example. They are almost useless at spotting terrorists, but civil-rights advocates worry about “function creep”, in which such systems are installed for one purpose and then used for another.

Similarly, new legislation has been proposed that would allow far more widespread wire-tapping and interception of Internet communications to combat terrorism. But would it actually improve security? “Broad surveillance is generally the sign of a badly designed system of security,” says Mr Schneier. He notes that the failure to predict the September 11th attacks was one of data sharing and interpretation, not data collection. Too much eavesdropping might actually exacerbate the problem, because there would be more data to sift. It would be better to step up intelligence gathering by humans.

The second area where security technology could do more harm than good is in the world of business. Technology introduced to improve security often seems to have the side-effect of reinforcing the market dominance of the firm pushing it. “Information-security technologies are more and more used in struggles between one company and another,” says Mr Anderson. “Vendors will build in things that they claim are security mechanisms but are actually there for anti-competitive reasons.”

One current, and highly controversial, example is Palladium, Microsoft's proposed technology for fencing off secure areas inside a computer. It might be very useful for stopping viruses; but it might also enable Microsoft to gain control of the standard for the delivery of digital music and movies.

Security, in sum, depends on balancing cost and risk through the appropriate use of both technology and policy. The tricky part is defining what “appropriate” means in a particular context. It will always be a balancing act. Too little can be dangerous and costly—but so can too much.

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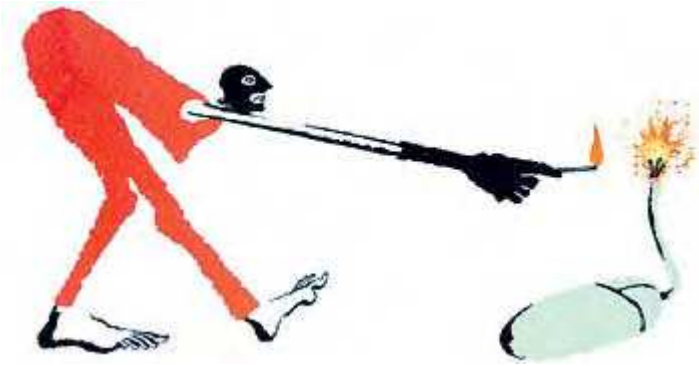
# The mouse that might roar

Oct 24th 2002
From The Economist print edition



**Cyber-terrorism is possible, but not very likely**

IT IS a devastating prospect. Terrorists electronically break into the computers that control the water supply of a large American city, open and close valves to contaminate the water with untreated sewage or toxic chemicals, and then release it in a devastating flood. As the emergency services struggle to respond, the terrorists strike again, shutting down the telephone network and electrical power grid with just a few mouse clicks. Businesses are paralysed, hospitals are overwhelmed and roads are gridlocked as people try to flee.

This kind of scenario is invoked by doom-mongers who insist that stepping up physical security since the September 11th attacks is not enough. Road-blocks and soldiers around power stations cannot prevent digital terrorism. “Until we secure our cyber-infrastructure, a few keystrokes and an Internet connection is all one needs to disable the economy and endanger lives,” Lamar Smith, a Texas congressman, told a judiciary committee in February. He ended with his catchphrase: “A mouse can be just as dangerous as a bullet or a bomb.” Is he right?

It is true that utility companies and other operators of critical infrastructure are increasingly connected to the Internet. But just because an electricity company's customers can pay their bills online, it does not necessarily follow that the company's critical control systems are vulnerable to attack. Control systems are usually kept entirely separate from other systems, for good reason. They tend to be obscure, old-fashioned systems that are incompatible with Internet technology anyhow. Even authorised users require specialist knowledge to operate them. And telecoms firms, hospitals and businesses usually have contingency plans to deal with power failures or flooding.

A simulation carried out in August by the United States Naval War College in conjunction with Gartner, a consultancy, concluded that an “electronic Pearl Harbour” attack on America's critical infrastructure could indeed cause serious disruption, but would first need five years of preparation and $200m of funding. There are far simpler and less costly ways to attack critical infrastructure, from hoax phone calls to truck bombs and hijacked airliners.

On September 18th Richard Clarke, America's cyber-security tsar, unveiled his long-awaited blueprint for securing critical infrastructure from digital attacks. It was a bit of a damp squib, making no firm recommendations and proposing no new regulation or legislation. But its lily-livered approach might, in fact, be the right one. When a risk has been overstated, inaction may be the best policy.

It is difficult to avoid comparisons with the “millennium bug” and the predictions of widespread computer chaos arising from the change of date to the year 2000. Then, as now, the alarm was sounded by technology vendors and consultants, who stood to gain from scaremongering. But Ross Anderson, a computer scientist at Cambridge University, prefers to draw an analogy with the environmental lobby. Like eco-warriors, he observes, those in the security industry—be they vendors trying to boost sales,

academics chasing grants, or politicians looking for bigger budgets—have a built-in incentive to overstate the risks.

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General Electric

# Solving GE's big problem

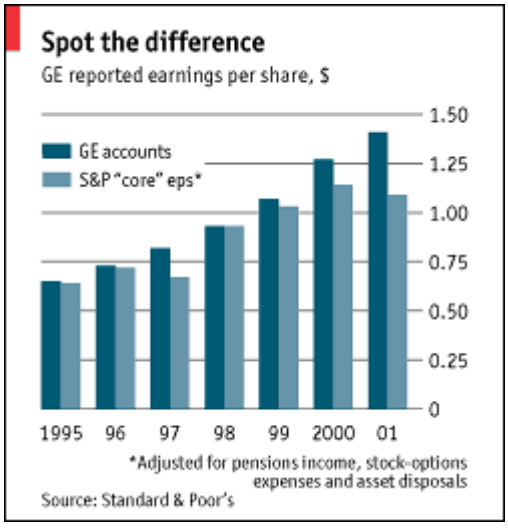
Oct 24th 2002 | NEW YORK
From The Economist print edition

**Should the world's biggest conglomerate break itself up?**

Get article background

PERHAPS growth at General Electric (GE) is starting to slow. Shareholders have bet on it all year, driving down the share price of what is still the world's second most valuable firm to nearly 60% below its peak in August 2000. Wall Street's ever-bullish analysts have begun to agree: five of the 14 analysts tracked by First Call, a research firm, rate GE stock a “hold” (translation for non-Wall Streeters: “sell”). Now, even the firm's protests seem to be losing force. GE may at last be preparing itself for a refreshing burst of honesty.

There are many reasons to think that GE cannot increase its profits in the long term, as the firm's former boss Jack Welch promised in 2000, by 18% a year. It has more than 300,000 employees and its annual sales top $125 billion. Mr Welch was surely kidding: mature industrial giants do not grow like start-ups. Indeed, the firm that made itself famous during the 1990s by reporting nine straight years of double-digit growth in profits may have never actually achieved double-digit growth rates in the first place. After removing from the numbers “non-core” profits such as gains on pension-fund assets, Robert Friedman of Standard & Poor's, a ratings agency, finds that GE's core profits grew by only 9.2% a year during 1995-2001 (see chart).




GE dismisses S&P's work as just another take on “pro forma” earnings—a reference to the much-discredited profits game played by analysts and firms that has mostly inflated reported numbers. S&P's exercise is, of course, deflating. Like a lot of American firms, GE booked windfall profits from its pension funds in the 1990s: last year, pensions income earned GE more than $2 billion, or 15% of its total reported profits. Because the stockmarket is now less exuberant, however, GE will probably miss out on such profits in the future.

Even growth of 9% a year may be hard to repeat on any consistent basis. The global economy is no longer as buoyant as it was in the late 1990s. This will hit profits at GE's cyclical businesses, such as plastics. GE profited handsomely from a bubble in America's energy markets, into which it sells power

turbines. In 1995-2001, profits in GE's power business grew by 37% a year, to over $5 billion last year—nearly 40% of total profits. The energy industry is now in a mess, as is the airline industry, another important GE customer.

**As GE Capital has grown, its prized triple-A credit rating has come under pressure**

Things ought to be brighter for GE's financial businesses, collectively called GE Capital, which have in the past thrived in recession by acquiring cheap assets. However, as GE Capital has grown (from under 30% of the conglomerate's profits in 1991 to 40% in 2001), its prized triple-A credit rating has come under pressure. The rating agencies say that they like the way GE manages its financial businesses. But they make it clear that GE can no longer allow GE Capital to grow faster than the overall company without sacrificing the triple-A badge. (Only nine firms still have that deep-blue-chip rating.) No matter how well run, financial firms are riskier than industrial ones, so the mix at GE must be kept right, say the agencies. As usual, the agencies seem to be behind the game: the credit markets already charge GE more than the average for a triple-A borrower.

Until now, guarantees from the industrial half to the financial half have let GE understate the true amount of capital tied up in its financial businesses. But the agencies are becoming stricter here too. Further financial-business growth, they say, will need to be built on the explicit foundation of extra shareholder funds on GE Capital's balance sheet. Arguably, this derating has been under way for some time, as the markets bet that GE will either allow GE Capital to grow unchecked, further tainting the quality of its earnings, or leave the finance businesses hobbled by slow growth on the industrial side.

GE seems to have two big ideas about what to do next. The first is to “reshuffle the portfolio”. Mr Welch would never have countenanced the sale of GE's historic lighting business. But his successor, Jeffrey Immelt, cannot afford sentiment. At a recent presentation to shareholders, lighting (which Mr Immelt merged, earlier this year, with GE's appliances business) ominously appeared under a column headed “re-position for value”. Also in this column were two financial businesses, Employers Reinsurance Corporation and GE Equity, both of which have given Mr Immelt headaches lately. Mr Immelt also said that he wants to buy new industrial businesses.

Mr Immelt's second idea is to begin managing GE Capital in the same way that Mr Welch managed GE's industrial arm, and thereby earned the nickname “neutron Jack”: by wringing out costs. At GE Capital, profits grew at the same rate as revenues during the 1990s, as it focused on growth through acquisitions. On the industrial side of the business, profits grew twice as fast as sales. In July, Mr Immelt said that he would reorganise GE Capital's 26 financial businesses into four big units, which seemed to presage bloodletting. Denis Nayden, the man who orchestrated GE Capital's acquisitions strategy, has been pushed to one side. Insiders say that Mr Immelt is now busy installing experienced industrial cost-cutters into GE's financial businesses. In Stamford, Connecticut, GE Capital's home town, company wives are preparing for pain.

## Wield the axe, Jeff

GE has long been the exception that proved the conglomerate rule: the firm really was worth more than the sum of its parts. Now, GE's shares no longer trade at a premium to the market. Some board members have even begun to talk privately about a “conglomerate discount”.

GE's industrial and financial halves used to help each other. GE Capital got the benefit of a triple-A rating; GE's industrial units got a captive finance company. But now, GE Capital has far outgrown its old captive-finance role. And increasingly, investors want to peer through GE's results to the health of GE Capital's balance sheet. Like it or not, the markets act as if the triple-A rating has already gone. The costs of sticking together, meanwhile, are mounting. GE's industrial businesses are clearly set for a miserable few years. However the firm configures itself, shareholders and creditors will punish any outperformance of the finance businesses over the anaemic industrial side. The jet engines and power plants have become a millstone around GE Capital's neck.

This points to a simple conclusion: break up the company and set GE Capital free. The markets are not demanding it, but it may be only a matter of time. Mr Immelt should seize the initiative, not wait to be forced into action. “Control your destiny”, goes the title of one adoring book on GE management, “or someone else will.”

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**ABB in crisis**

# All over?

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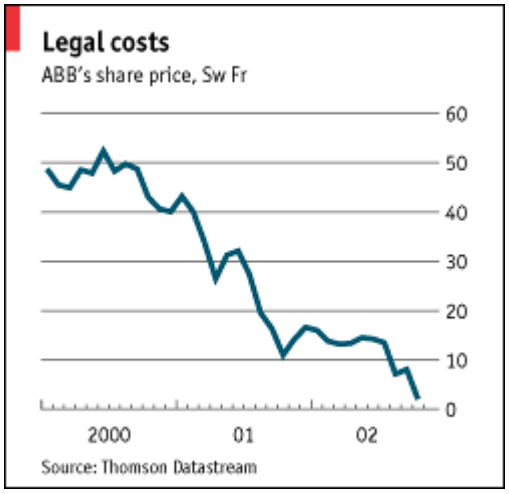
From The Economist print edition

**Europe's second biggest engineering group is dangerously close to collapse**




JURGEN DORMANN was supposedly a safe pair of hands, a sensible manager who could steer his way through a crisis. That is why in September he was made chief executive (he was already chairman) of ABB, a stricken engineering group that was once Europe's answer to GE, but has been struggling for months with a severe financial and operational crisis. Don't worry, he said as he took up his post, ABB would meet its targets for improving earnings and reducing its $5.2 billion of debt.

Imagine the stockmarket's horror, then, when Mr Dormann revealed that on his brief watch things had become far worse. On October 21st he issued a profits warning, three days before releasing dismal third-quarter results. He said that poor internal reporting had led senior managers, and consequently him, to be complacent. Targets have now been abandoned, but it is a mystery why so experienced a manager ever trusted the original numbers or presided over so slack an internal culture.

Mr Dormann also revealed that ABB's liabilities for asbestos-related legal claims threaten to spiral out of control. Combustion Engineering (CE), acquired in America over a decade ago, might enter bankruptcy in a last-ditch effort to protect its European parent from further claims. ABB said that the liabilities now exceeded CE's $812m of assets. Analysts have long argued that ABB was underestimating its asbestos liabilities, which some put at $2 billion-3 billion. They were not pleased to be vindicated.

This double piece of bad news proved more than the markets could bear. On October 22nd, ABB's already feeble shares fell by more than 60% (they fell further the next day) and its bonds traded at half their face value. Credit-rating agencies cut ABB's rating to near-junk status. Mr Dormann was left to utter reassurances that he does not expect ABB to fail and that he will find out how much of the firm's previous optimism was wishful thinking. The problem is that nobody in the markets trusts him, nor are they likely to anytime soon.

Break up or bankruptcy are now real possibilities for ABB. It finds itself on a danger list with other troubled European groups such as Fiat and Vivendi Universal. Saddled with too much debt, their efforts to work their way out of a financial crunch have been hampered by poor economic conditions and weak customer demand. Selling assets looks the obvious way out of trouble, but this is a buyer's market and prices are disappointing. On October 24th, ABB announced that it would dispose of its oil, gas and petrochemicals business, and also cut costs by $800m.

ABB has added to its woes by its mishandling of its asbestos liability. Last month it lost an appeal designed to stop a court in West Virginia from hearing a case lumping together 250 separate cases involving 8,000 claimants from all over America. ABB has now chosen to settle the cascade of cases, hoping to limit the damage by placing CE into bankruptcy. Even if that route, which will take time to navigate, proves feasible (many lawyers think it doubtful), the tactic will require ABB to inject cash into the defunct entity to match the asbestos liability. That would probably force it to make a rights issue or another emergency disposal of its assets. Assuming it is still around, that is.

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German business

# Comrades no more

Oct 24th 2002 | FRANKFURT
From The Economist print edition

**Why German bosses are increasingly furious with their government**

IT TAKES effort to recall that Gerhard Schröder, Germany's chancellor, was once dubbed “Genosse der Bosse” (“comrade of the bosses”). In its gut, his Social Democratic Party sides with trade unionists rather than business, yet in his first term Mr Schröder often won cheers from the capitalists, especially for cutting corporation- and income-tax rates and exempting from capital-gains tax sales of German companies' still-widespread shareholdings in one another.

Before September's general election, however, Mr Schröder stressed his leftness. Now that his coalition of Social Democrats and Greens has been re-elected, the chancellor's old pals in pinstripes are furious at its ideas. Though cuts in income-tax rates are still planned for 2004 and 2005, they are hopping mad at plans to haul in more from other taxes, especially on firms, to plug Germany's gaping budget deficit. This looks certain this year to breach 3% of GDP, probably triggering corrective action under the euro area's stability pact.

Germany's business press has been packed with outraged quotes from bosses, both of big companies such as Metro, a retailer, and Commerzbank, the country's fourth-biggest bank, and from the Mittelstand, the mainly small, owner-run firms that make up most of corporate Germany. To be sure, some of the huffing has been exaggerated—such as a hint, since denied, that Siemens, a huge engineering and electronics company, might quit Germany. Even so, says Roland Berger, eponymous head of a Munich consulting firm, “I fear companies will move away.”

A prime cause for complaint is a proposal to limit, to seven years, the carrying forward of losses to set against profits when totting up corporation tax. Also, firms will be able to set past losses against at most half of any year's profits—ensuring that they will have to pay some tax whenever they are in the black. On top of this, contribution rates for the state pension scheme, which are split between employers and workers, will rise. So will the maximum contribution for both pensions and unemployment insurance, and the minimum salary needed to opt out of state health insurance. Exemptions granted to industry from Germany's “ecological” energy tax will be cut back. Value-added tax will be payable on flights to other European Union countries. Shares held by individuals for more than one year will be liable to capital-gains tax.

Hans Eichel, the finance minister, portrays all this not as an increase in taxes but as a closing of loopholes and cutting of subsidies—making the tax system more efficient, you see. The German tax system is indeed riddled with exemptions, which narrow the tax base and push up tax rates, and most experts on efficient taxation agree it would make sense to do away with them. Why, for instance, should VAT be paid on flights within Germany, or to non-EU Switzerland, but not on flights to Britain? But the coalition has drawn up a hurried hit-list, not a reform: lots of anomalies are untouched while some changes—including the restriction on firms' ability to carry losses forward—head the wrong way. More fundamentally, Mr Eichel is not broadening the tax base so as to cut tax rates, but to raise the tax burden. Tax experts do not agree that this is efficient.

The government, it seems, cares far more about its lack of cash than about tax theory. Take corporation tax, from which revenue has collapsed: last year and this, firms have been net reclaimers of tax. This mostly reflects falling profits, which will hopefully prove temporary. And some of the shortfall is more apparent than real. As a result of reform in Mr Schröder's first term, says Viktor Steiner of DIW, a Berlin economics institute, some tax on distributed profit now shows up as income tax (paid by shareholders) instead of corporation tax. Nevertheless, the government wants to make large firms pay more.

Maybe firms will not do as badly as they fear. Mr Schröder has to clarify his plans and win parliamentary

approval—easier in the lower house, where he won a thin majority in the election, than in the upper, where the opposition is in charge. And the chancellor has changed political tack before. Indeed, Mr Berger suggests the economy's weakness may yet push him back towards pro-business reform. For now, though, all that counts is filling empty coffers. *Auf wiedersehen*, comrade.

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AOL Time Warner

# A steal?

Oct 24th 2002 | NEW YORK
From The Economist print edition

**Lawsuits claim that the media merger of the century was based on fraud**

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**An open and shut Case?**

AT THE time, in January 2000, it was billed as the deal of the century. Now it is regarded as the steal of the century, AOL having acquired the considerable assets of Time Warner with shares that it is now clear were massively overvalued. Indeed, several lawsuits claim that AOL was not merely a brilliant deal-maker; it may literally have stolen Time Warner.

To secure its prize, AOL offered a premium of almost $50 for Time Warner's stock, then trading at $65. Nearly three years later, and two years after the deal closed on January 11th 2001, shares of the now combined firms trade for 90% less than at their pre-merger peak. Over a dozen shareholder suits claim that what allowed AOL to support so lavish a price was fraud. The theory in each of the suits is that a series of "materially false and misleading" financial statements resulted in AOL's share price being far higher than would ever have been the case had more accurate data been disclosed. On October 23rd, the firm said it would restate its revenues for the past two years after an internal investigation into AOL's accounts.

No doubt an argument could be made that financial results were irrelevant to the euphoric prices paid for Internet shares. Still, the case poses a huge threat to the former boards of both firms, their accountants, bankers and other advisers. First in line are Ernst & Young, AOL's accountant, as well as key executives, including Steve Case, its former chief executive who is now chairman of AOL Time Warner; Time Warner's former chief executive, Gerald Levin; and the merged firm's current chief executive, Richard Parsons.

Given America's addiction to litigation, it is hard to imagine that the investment banks advising on the deal will escape attack, though they have not been named so far. Collectively, they received $120m in fees, according to Thomson Financial. Goldman Sachs and Merrill Lynch advised AOL. Even though, in retrospect, they appear to have helped the firm cleverly to transfer ephemeral paper wealth into something more substantive, Time Warner shareholders are likely to argue that they were sold a false bill of goods. Citigroup's Salomon Smith Barney provided AOL with a "fairness" opinion, the very notion of which seems suspect given the subsequent collapse in share prices. Time Warner was represented by Wasserstein Perella and Morgan Stanley. Together, the banks played an important part in the due diligence on AOL that Time Warner had a fiduciary duty to perform before closing the deal. If the case ever reaches trial, it will be interesting to learn what, in practice, requirements such as "due diligence" and "fairness" opinions really mean.

Most of the suits were inspired by a long article in the *Washington Post* this summer that accused AOL of covering up the deterioration in Internet advertising that began in the summer of 2000, six months after the purchase of Time Warner was announced. At the time, the dotcom mania had already begun to subside and any firm showing flagging revenues was suffering a precipitous fall in its share price.

The main accusations in the lawsuits can be split into two categories: revenue claimed to be from advertising that came from elsewhere (such as legal settlements), and revenue claimed to be from advertising that was not revenue at all (such as barter deals with ads swapped between Internet sites). As new lawyers enter the fray, fresh claims are being added, such as the contention

**The main accusations can be split into two categories:**

that AOL never disclosed the dire financial condition of its European operations (prior to its forced assumption of Bertelsman's stake in January 2002).

More claims, and more defendants, will be added in the months ahead, lawyers say, before the claims are finally combined and a lead plaintiff is chosen. A big uncertainty is whether current investigations into AOL Time Warner's accounts by the Justice Department and the Securities and Exchange Commission (SEC) will result in prosecutions. Awkwardly, among the attorneys defending AOL's accounting practices in the period before the announcement of the merger was Harvey Pitt, now chairman of the SEC. Given the current scepticism about him, the investigation will have to be very thorough.

**revenue claimed to be from advertising that came from elsewhere, and revenue claimed to be from advertising that was not revenue at all**

Not helping the company's cause is the massive sale of AOL Time Warner shares by executives after the announcement of the deal. The 14 executives, who realised $256m, included Mr Parsons ($35m) and Mr Case ($50m), all at prices far higher than today's, according to a complaint filed by Johnson & Perkinson, a Vermont-based law firm. Conspicuously absent from the list is Mr Levin, who did some selling but also, according to Vickers, a tracking service, bought 2.3m shares at a time when the price for each share exceeded $43. That investment has been a personal disaster for Mr Levin. Perhaps he will join the litigation. As an aggrieved shareholder, he may finally reap a windfall from his deal.

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Foreign firms in Japan

# Finding hidden talent

Oct 24th 2002 | TOKYO
From The Economist print edition

**More and more Japanese want to work for the gaijin**

THEY have stood up to be counted, and they are just over a million strong. That is how many Japanese now work for foreign firms operating in their country, according to the Japan External Trade Organisation (JETRO), which released its first survey of foreign firms' employment on October 22nd. By the standards of rich economies, that is still a small number: roughly 2.3% of the workforce, compared with well over 5% in the United States and Germany. But given the insularity and inflexibility that still hobble too many Japanese firms, this small source of alternative jobs offers an outlet for those who are getting a raw deal in corporate Japan.

In general, foreign firms in Japan attract people whose talents are either under-rewarded or allowed to waste away in local companies. That applies especially to women, who despite high education levels are in much less rewarding white-collar jobs than their western counterparts. Indeed, bright Japanese woman lose out to slower and lazier men so frequently in office jobs that even being a flight attendant is considered a high-flying career for more than the obvious reason. Of the Japanese firms that female graduates most want to work for, two are airlines and one is NHK, a large broadcaster.

In such an environment, foreign companies are only too happy to recruit female talent. JETRO, which like most Japanese organisations seems uninterested in whether such talent is being wasted, did not bother to count how many of those million workers were women. But judging by the number of overqualified female MBAs and law-school graduates who are queuing for even a basic job as a secretary, it is a high percentage.

Men who want to be paid for their performance—ie, those who are clever and productive—are also increasingly drawn towards foreign firms. This is not surprising, since many Japanese companies continue to reward conformity and seniority over cleverness and talent. Jesper Koll, chief economist at Merrill Lynch in Tokyo, points out that the spread between salaries in Japan has begun to rise over the past few years, though it is still much lower than in Britain or the United States. One reason for this, he says, is that pay-for-performance is increasing in Japan. Foreign firms appear to be leading this trend, which started with foreign investment banks.

To some extent, however, bright young Japanese college graduates are still drawn towards Japanese companies that are considered safe and prestigious. Unsurprisingly, the three most popular places for male university graduates are Sony, Honda and Toyota. And IBM Japan, which young Japanese say is ninth on their list of favourite employers, is now considered to be practically a Japanese company by many locals.

However, if Japanese firms learn to tap Japanese talents, some may recruit professionals who have worked for a foreign firm, as some Japanese banks have tentatively begun to do. Might that tiny 2.3% of the workforce contain a bigger share of Japan's future business leaders?

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Aviation in greater China

# Change in the air

Oct 24th 2002 | HONG KONG
From The Economist print edition

**New opportunities, and bigger threats, for Cathay Pacific**

LAST weekend, negotiators from America and Hong Kong finally concluded three years of tortuous talks by partially liberalising aviation between the two. For Cathay Pacific, Hong Kong's de facto flag carrier, that makes the skies over the Pacific a bit clearer. It can now fly to any American city, and it can share flight codes with American Airlines for onward journeys. But Cathay has yet to solve a far trickier puzzle: getting privileges to fly around in what is now its own country, China.

Greater China is a uniquely complicated market, because it consists of four separate aviation jurisdictions. Three of these—the mainland's, Hong Kong's and Macau's—are looked after by their governments and one—Taiwan's—by a sort of trade association, since the other three authorities do not recognise its government. But by the same token (in essence, the politics of China's unfinished civil war), the market is also lucrative. Because the Taiwanese may not travel directly to the mainland, they must pass through Hong Kong, making the route between Taipei and Hong Kong the busiest in the world.

Cathay has made oodles of money on this route over the years, but it has not been allowed to fly Taiwanese passengers onward to the mainland. In 1985, when a second passenger carrier, Dragonair, was founded in Hong Kong, the then colonial government adopted a policy of “one route, one airline” to protect the fledgling. Cathay had to give all its mainland rights to Dragonair, while Dragonair could not compete on Cathay's international routes, including to Taipei. In turn, Cathay was compensated with a powerful stake in Dragonair and agreed to supply it with some back-office support.

The arrangement was not cosy for long. In the run-up to Hong Kong's return to China in 1997, Beijing grew suspicious of Cathay, which is part of the Swire Group and so ultimately British. Beijing wanted its own powerful aviation presence in Hong Kong, and threatened to launch a new airline. Cathay, by this time virtually running Dragonair, dissuaded the Chinese only by granting them a controlling stake in its erstwhile partner and by giving mainland-controlled firms two board seats and a stake in Cathay itself.

As a market, meanwhile, the mainland boomed. In 1990, 23% of all flights through Hong Kong were to or from a mainland city; this year the proportion is about 31% of a much larger number. Cathay could no longer afford to keep ignoring its hinterland, just as Dragonair, now in effect a mainland carrier, was increasingly loth to play second fiddle to Cathay.

As a result, the “one route, one airline” policy—never actually formalised in law—began unwinding this year. Dragonair asked for, and got, rights to fly to Taipei in June. It also asked for access to Manila, Tokyo, Seoul and Sydney. In September, Cathay said it would not object, but at the same time tabled its own request to renew services to Beijing, Shanghai and Xiamen, the mainland's big profit-spinners, which it had lost in 1985. Dragonair objected at once. Whatever is left of their dalliance is now only in the back office. Peter Negline, an analyst at J.P. Morgan in Hong Kong, expects that this new competitive edge will lead the two firms to unwind the remains of their relationship within two years.

Adding urgency to this is a massive restructuring of the mainland's airline industry on October 11th, when Beijing merged ten state-run carriers into three national champions. Dragonair, through its mainland ownership, belongs to one of these, the Beijing-based Air China group. Cathay has begun talking to another, China Eastern, whose hub is in Shanghai.

In a perfect world, however, Cathay would be talking to the third: China Southern, whose home is in Guangzhou, just up the Pearl River from Hong Kong. It has the most domestic connections of the three mainland giants, and so could, in theory, dovetail perfectly with Cathay's international connections. The trouble is, says David Dodwell, a consultant in Hong Kong, that officials in Guangzhou see Hong Kong,

and Cathay, as the enemy to beat. Given the current chaos caused by the domestic restructuring and their relatively poor (though improving) service quality, it will be years before they have a chance of doing that. But in the longer run, as one director of Cathay admits, “China Southern is the most frightening airline.”

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Sub-Saharan African oil

# Black gold

Oct 24th 2002 | JOHANNESBURG
From The Economist print edition

**America is increasingly interested in Africa's oil reserves**

WHY are Americans suddenly flocking to western Africa? Men with Texan drawls and colourful overalls crowd the beachside bars in Luanda, Angola's capital. In September Colin Powell paid a flying visit to Angola and Gabon; early next year George Bush is expected to follow suit. Last month ten African heads of state visited the American president. Rumours fly at cocktail parties in African capitals that the United States plans a military base in Sao Tome and Principe, an island country in the Gulf of Guinea.

The reason is oil. Walter Kansteiner, America's assistant secretary of state for Africa, suggests that "African oil has become of national strategic interest to us." In quiet moments he confides that it is the only American interest in Africa. Although the continent has a mere 7% of the world's known oil reserves, big new discoveries off the west coast are exciting oil firms. At a meeting this month in Cape Town, South Africa, they queued up to boast of their planned investments. Chevron Texaco said it had spent $5 billion in the past five years in Africa, and would spend $20 billion in the next five. Shell said it would double its oil and gas production in Africa over the same period. BP plans billions of dollars of spending in Angola alone. This month President Thabo Mbeki launched a new South African state company, PetroSA, so that his country can also tap west Africa's reserves of oil and gas.

There are strategic reasons why western countries and firms are keen. Dick Cheney's National Energy Policy Report suggests that the region is one of the "fastest-growing sources of oil and gas for the American market". African oil already provides 15% of American imports; that is likely to rise to 25% by 2015, lessening to a degree dependence on supplies from the troubled Persian Gulf.

**African oil already provides 15% of American imports; that is likely to rise to 25% by 2015**

More African exports would also mean more non-OPEC oil. In sub-Saharan Africa only Nigeria is part of OPEC, and there will eventually be a lot of non-OPEC exports from Chad, Sao Tome, Equatorial Guinea and especially Angola. Angola produced roughly 750,000 barrels per day (bpd) in 2001, and capacity is soaring. In Nigeria capacity is already well over its production quota of 1.8m bpd. As that rises, some observers hope that the country may be persuaded to break away from the largely Arab cartel, though this is a long shot.

Investments are not driven by American strategic interests alone. "It is more important that African oil is good quality and companies can get good recovery rates," says Duncan Clarke, an expert on African oil. Though not as pure and light as Saudi oil, west African crude is easily good enough for refineries on America's east coast. It is also usefully close, half the distance of Persian Gulf supplies. And most big discoveries are being made off-shore. In some cases companies are identifying oil that is under extremely deep oceanic shelves, and must wait until technology makes efficient exploitation possible.

Another appeal of off-shore oil is its lower risk of bad publicity, such as that Shell earned for its activities in Ogoniland in Nigeria while the country was under military rule. There a local activist, Ken Saro-Wiwa, and eight others were arrested and hanged in 1995 after campaigning against the misuse of local oil revenues. On October 23rd Human Rights Watch produced a report on the impact of oil in Nigeria, concluding that ordinary people have seen hardly any benefit while elites have become extremely rich. Confrontations with oil companies continue.

But even off-shore extraction carries some risks. Oil rigs are sometimes invaded by protesting activists. Ownership of off-shore reserves may be disputed. On October 23rd, Nigeria rejected a world court ruling handing the oil-rich Bakassi peninsula region to Cameroon. Last week a leaked report from the IMF suggested that Angola's rulers had personally pocketed as much as $1 billion a year from oil revenues.

Activist groups such as Global Witness are increasingly vocal in criticism of oil firms, which pay hidden “signature bonuses” to gain access to west African oil. BP revealed that it had paid Angola's government such a bonus in the late 1990s, and drew a storm of criticism from other oil companies—especially American ones, which may be fearful of falling foul of the Foreign Corrupt Practices Act—and from Angola's rulers.

But none of that will deter investors, who see good oil to extract and a hungry market across the Atlantic. Mr Bush's planned visit is likely to stir up even greater interest in African oil. Expect many more American oil workers to spend their free time in west Africa's bars.

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**Eli Lilly**

# Bloom and blight

Oct 24th 2002
From The Economist print edition

### Despite its poor results, Lilly's future may be rosy

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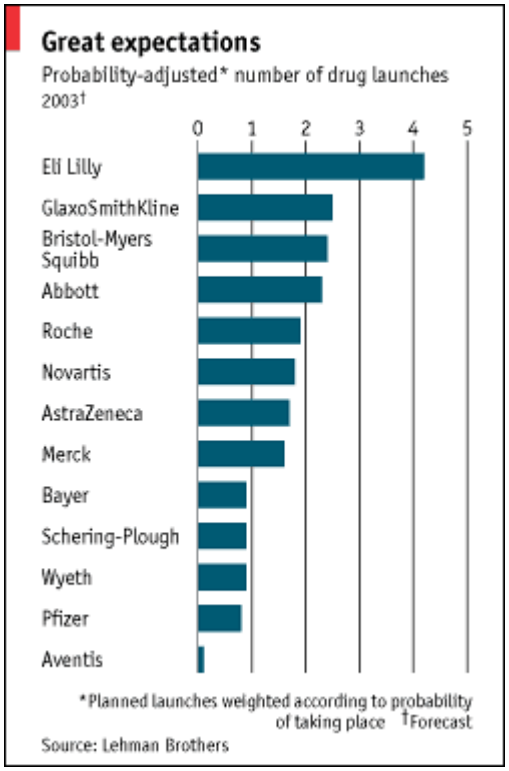


FOR an industry that prides itself on innovation, firms with promising new drugs in development are surprisingly rare. By the end of this year, Lehman Brothers, an investment bank, expects global drugmakers to have launched 47 new drugs, a third fewer than in 1997. Many firms face yawning gaps in their pipelines of drugs at a late stage of development. Yet Eli Lilly, based in Indianapolis, is poised to launch at least four novel drugs next year, with total potential annual sales of more than $5.5 billion (see chart). This is ample reason to be optimistic about a firm that this week issued lacklustre results and another profit warning.

Much of the firm's innovative edge is attributed to Sidney Taurel, a globe-trotting European whose exotic background and urbane manner make him a far cry from the average mid-western executive. Like his fellow pharma boss, Raymond Gilmartin at Merck, Mr Taurel has avoided the industry addiction to mergers since becoming chief executive in 1998. He thinks that size can do more harm than good in pharmaceuticals, since giants take more energy to grow than leaner creatures. He says that American medicine would have to alter dramatically through, say, widespread price controls, before a sharp change in Lilly's course made sense.

At the moment, Lilly concentrates its R&D budget of more than $2 billion on tackling a few diseases promising potentially huge rewards for successful drugs, such as diabetes, osteoporosis, cancer and depression. Mr Taurel pins some of the firm's research productivity on the way it organises its various stages of research and uses medical specialists early in product development. One of its likelier prospects, Strattera, a new alternative to Ritalin for attention deficit hyperactivity disorder, was a floundering treatment for depression until some of the firm's research psychiatrists had a hunch about its hidden promise.

Equally important is the firm's early embrace of biotechnology. Lilly is one of the few large pharma companies with an in-house expertise in protein-based pharmaceuticals that matches its strengths in more conventional drug discovery. Mr Taurel reckons this homegrown experience makes Lilly a more attractive partner than its rivals for biotech firms seeking ties to a bigger business. Indeed Lilly has roughly 140 alliances with outside firms, both bringing in promising molecules and farming out its own.

**Lilly has roughly 140 alliances with outside firms, both bringing in promising molecules and farming out its own**

But alongside Lilly's embarrassment of R&D riches is a costly embarrassment over manufacturing. Two of its shiny new products—Forteo for osteoporosis and Cymbalta for depression—were originally due to launch this year, but have been delayed by America's Food and Drug Administration (FDA) until Lilly resolves problems with its drug production processes. Most of the regulator's complaints centre on quality control at the firm's main Indianapolis facility—though it seems that the principal issue was administration rather than anything scarier. Mr Taurel admits that Lilly was not structured in such a way as to recruit, and retain, bright sparks in manufacturing, as well as in the more glamorous business of R&D. To boost the appeal of

manufacturing, salaries have now been raised along with status in the corporate hierarchy.

There are few other industries whose fortunes are so dependent on regulatory vicissitudes. But the success of Lilly's forthcoming products ultimately lies in its own hands. This makes some folk wonder if the firm has enough resources to launch on so many fronts in so little time, and if it might have to divert resources from other products, such as Zyprexa, its blockbuster drug for schizophrenia, thus leaving them more vulnerable to competition.

Mr Taurel, on the other hand, reckons that Lilly can manage most of these launches on its own, since it will be concentrating its marketing on a relatively few specialists rather than the wider world of general practitioners. Although the success of drugs such as Prozac proves Lilly's marketing skills, the firm is not infallible: Xigris, its hot new treatment for a deadly condition known as sepsis, has had a lacklustre debut, in part because Lilly targeted too exclusive a group of specialists. As a result, the firm's third-quarter profits, announced on October 23rd, rose by a paltry 2% over the previous year.

Its short-term outlook may be sluggish, but even that is remarkable given Lilly's near-death experience in 2000. When one of its key patents on Prozac was overturned in court, roughly a third of its share value vanished; within a month, the firm had lost 70% of sales to generic rivals. With hindsight, Mr Taurel says it should have been better prepared, and introduced more quickly its successor drugs to Prozac.

It is a mistake he is determined to avoid repeating. Today, each new product going into mid-stage clinical trials has a team of scientists, marketers and regulatory experts who work together to map out its future, from scrutiny at the FDA to patent expiry, ensuring that their molecule lives up to its full potential. This approach to managing product life-cycles is arguably more effective than the desperate machinations of some pharmaceutical companies to spin out patents on their ageing stars.

This week the White House moved to halt some of these antics by proposing regulations that would limit pharmaceutical firms to a single automatic 30-month extension on their patents when challenged by a generic rival, and prevent them from prolonging their monopolies with frivolous patents. For Lilly, lawsuits and flaws may pose a bigger threat. On October 22nd, Pfizer won a new, broad patent on Viagra, its anti-impotence drug, in America and sued Lilly to block the launch of Cialis, its longer-lasting alternative. And for all their clinical potential, Lilly's bright new drugs could still falter. Although the best relief for patent-induced depression is the promise of new products, headaches are an unavoidable side-effect.

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**Face value**

# Listen, Mario

Oct 24th 2002
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**Europe's competition policy needs clearer guidelines and better administration**

MANY American businessmen have regarded Mario Monti as the corporate equivalent of Saddam Hussein ever since he dared last year to block Jack Welch's audacious bid to merge Honeywell into GE. Though fears that Europe's chief trustbuster would provoke a trade war over merger policy have subsided, not least because merging is currently so unfashionable, those businessmen feel that European competition policy is in urgent need of, ahem, “regime change”.

Nor is it only Americans who criticise Mr Monti and his Merger Task Force (MTF), the body within the European Commission responsible for reviewing deals and making policy. Whereas some Europeans admire their man for standing up to the Yanks, others—especially those who have direct dealings with him and his team—worry about Mr Monti's methods and decisions, which are increasingly being challenged in court. Even the GE-Honeywell decision, perhaps the bitterest of a series of adversarial cases, is under appeal. In a year or so Mr Monti's greatest triumph might be overturned.

Mr Monti shrugs off such criticisms, saying that he is only doing his job. This combination of Northern Italian cool with a hint of insouciance has been on display again lately following two big legal defeats for the MTF. On October 22nd, judges at the European Court of First Instance ruled that the commission was wrong to block the merger last year of Schneider and Legrand, two French electrical equipment makers. That followed a similar, excoriating, ruling in June involving First Choice and Airtours, rival British tour operators that were prevented from merging in 1999. A verdict on another blocking decision made by the commission last year—involving Tetra Laval and Sidel, two packaging companies—was expected on October 25th, after *The Economist* went to press.

“If Mr Monti doesn't now accept that there is something rotten at the heart of European merger policy, then he never will,” says Chris Bright of Shearman & Sterling, an (admittedly American) law firm. But Mr Monti explains these reverses away. He had been in office only for five days when the First Choice-Airtours decision was made, so it was not his fault. He has voluntarily started a process of internal reforms. As for the court's ruling on Schneider-Legrand, it merely showed that effective judicial review is available to companies that disagree with rulings. Besides, few mergers are blocked.

But the court's comments on how the Schneider-Legrand case was handled suggest a situation that is harder to defend. The judges identified two areas where the MTF had manifestly failed to do a competent job. First, its economic analysis of the relevant electrical markets was marked by “errors, omissions and contradictions”. The MTF muddled its arguments and over-estimated the combined group's likely economic power.

Second, the court described a procedural failing so serious that Schneider had, in effect, been denied its right to conduct a reasonable defence of its merger. When the MTF made its original “statement of objections”, a formal document listing its reasons for making an in-depth investigation of the deal, it

noted one main problem. Schneider duly concentrated its defence on that, only for the deal to be rejected on quite different grounds, leaving it no time to suggest remedies.

## First, a coherent policy

Such a public savaging means that Mr Monti must, as a matter of urgency, demonstrate that he presides over a fair and sensible competition regime. If that means ripping up the modestly reforming Green Paper he is currently thought to be preparing, to have a more fundamental rethink, then so be it.

A first essential is a coherent policy. Americans often complain that the commission sees markets in static, not dynamic, terms. But the real problem is that the commission has no clear policy framework against which officials and companies alike can test mergers. Instead, MTF officials frequently appear to make merger policy on the hoof, because they know how to use the commission's opaque procedures to frustrate supplicant companies. In both the GE-Honeywell and Tetra Laval-Sidel cases, for example, a new and controversial theory of “bundling”, by which a merged company might crush competitors using a broad range of related products, was inserted into the economic case for blocking decisions. The theory could yet be discredited, but in the meantime it has become a main plank in European merger policy.

**The commission has no clear policy framework against which officials and companies alike can test mergers**

Mr Monti will find it easier to alter this on-the-hoof approach if he employs a chief economist, something he has already hinted that he wants to do. That should be a top priority. One of the worst elements revealed by the court rulings is the MTF'S sloppy economic reasoning in controversial cases.

Just as crucial is procedural reform. True, the MTF tends to rule on a merger more quickly than do its counterparts in America. A bad decision, taken in haste, can always be reversed on appeal. But by then, the opportune time to merge may have passed. It is therefore crucial to get the decision right first time.

Mr Monti could alleviate this problem by making his case officers more accountable during the merger review process. Within the commission, work could be monitored by specialists appointed to challenge poor thinking. Case files could be more transparent and available for regular scrutiny by interested parties.

If procedures could be made more straightforward and officials more accountable, merger policy should become accordingly more consistent. There would then probably be many fewer complaints. Officials might dislike the new constraints on their power. But drastic measures are needed to restore credibility to European merger policy. Mr Monti faces his defining challenge. But is he listening?

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**Raising finance in America**

# Doors now closing

Oct 24th 2002 | NEW YORK
From The Economist print edition

**Signs of a crunch in America's markets for credit**

"TWO months ago, I would have said the chances of a credit crunch were too small to measure," says the head of syndicated loans at a big American bank. "Now, they are better than evens."

The signs are ominous: low new-issue volumes for corporate securities, both debt and equity; falling amounts of loans extended by commercial banks; and a higher price for borrowing. A fairly benign explanation of the low volumes is falling demand for money among companies, after a surge of investment in the 1990s. Few companies, after all, want to build factories these days, or invest so much as they once did in information technology. Overcapacity remains. Meanwhile, the suspicion that consumers must soon cut back on their heavy spending justifies inventories kept as lean as possible, along with their financing.

Yet evidence continues to grow that the supply of capital is being shut off, too. It is a process that started with the riskiest securities—that is, junk bonds and new issues of shares—but is now spreading to the safer parts of the credit markets, including those for bank loans and for high-grade corporate bonds.

In recent months, the decline of the junk-bond market has accelerated. Even if you do not count the large quantity of bonds issued by telecoms companies that are now bust or nearly so, the average junk issue trades at a yield of some ten percentage points above Treasury bonds. That is a larger premium even than during the financial crisis caused by the collapse of Long-Term Capital Management in the autumn of 1998.

A mere $600m of junk debt is now being issued each month, one-eighth the amount of a year ago. The number will now bounce up a bit, but only briefly. Some $1 billion of junk bonds are being offered to help finance the $7 billion leveraged buyout of QwestDex, the yellow-page business owned by Qwest, a telecoms company desperate to raise cash. Another $900m is to be issued to finance the acquisition of a similar business owned by Sprint, another struggling telecoms company. Such directories are a dull, predictable business, and the bonds are rated junk only because of the high levels of leverage used for the acquisitions. After these big financings, little is in the pipeline.

Many companies would love to cut their heavy debt by issuing shares. Yet public offerings of shares ground to a halt in the summer of 2000, and the market has yet to recover. An alternative way for companies with less than stellar ratings to get through tricky periods used to be to set up special entities that would buy receivables from the parent company, using money that was raised cheaply from the capital markets. As bills were paid, so the money was repaid. Yet after Enron's abuse of this structure, special-purpose vehicles have fallen into disrepute.

Earlier this year, the vast market for commercial paper suddenly dried up, but this was not an insurmountable problem for highly rated companies, which could draw down lines of credit, previously arranged with banks, or tap the market for long-term corporate bonds. No longer. Banks have jacked up the price for back-up credit lines, when they offer them at all. And where the best corporate bonds once yielded less than a percentage point above Treasuries, new-issue spreads have now widened to almost three percentage points. In other words, not all of the Fed's cuts in interest rates since the start of last year have fed through to companies.

Bankers once went about marketing loans or bonds of highly rated companies merely by mentioning the name of the issuer. Now they have begun organising road shows for borrowers, complete with the elaborate disclosure of information, in a way once done for equity offerings. It is not an easy sell. The number of possible customers has shrunk. Some loan syndicates for large companies now have half the participants that were in them before. Japanese banks, in particular, have pulled out, along with German ones. But American banks also have less appetite for risk. According to BCA Research in Montreal, the percentage of American banks' assets made up of securities, notably safe government bonds, has grown from 34% at the beginning of 2001 to more than 40% today (see chart), with loans falling as a proportion.

That the tightening may continue is clear from recently disclosed results from the annual credit review carried out by the Federal Reserve, the Federal Deposit Insurance Corporation and the Comptroller of the Currency. The review assesses all loans over $20m that are syndicated to three or more borrowers. It amounts to $2 trillion in loan commitments to 5,500 customers, or roughly a third of all corporate lending in America. The review employs five grades, with the best grade, a “pass”, signifying a clean bill of health.

Almost 13% of all loans failed to get a pass, compared with 9% of loans last year and just 5% of loans the year before. The practical implication for banks is that they must apply more capital against the loans that have been fingered, or else arrange some other kind of so-called credit enhancement. Either way, the loan becomes less profitable. In effect, they must charge more or reduce their exposure.

Curiously, because the review is supposed to be a matter between regulators and banks, there are strict prohibitions against telling companies that their credit standing has been slashed. Rather, companies guess that this has happened only by facing a testy renegotiation with their lenders. Plenty of such discussions are going on. If companies are unhappy, they cannot challenge the methodology. Nor has any outside work assessed the accuracy of the rating system. A company that has been downgraded can, naturally, seek to arrange a better deal by selling debt or equity through the public markets. This year, that is not much of an option.

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Energy trading

# Watt price

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**Energy-price indices in trouble**

WHAT is the price of power in Peoria? The answer is more complicated than you might think, for America's markets for electricity were murky even before the collapse of Enron. Now, as hard evidence mounts of price manipulation by energy traders, efforts are under way to clean things up.

One reason electricity and gas markets have not been good at revealing prices is that most contracts, until recently at least, were not traded on a transparent exchange. Rather, the deals were done as bilateral contracts directly between utilities or power marketers. That created a market niche for publishing companies such as Platts, an arm of McGraw-Hill: its reporters ring all the big market participants every day and ask them what deals they have done. The price indices that result have provided the benchmark against which many energy contracts and derivatives have been pegged over the years. Companies such as Platts came to be known as the honest brokers of the power game.

In the past few days, however, Dynegy and American Electric Power both confirmed that their traders gave false information to price-reporting agencies. Earlier, it had emerged that Enron's traders had done the same. These revelations have spurred the Commodity Futures Trading Commission and the Federal Energy Regulatory Commission to look into the matter.

Platts is now tightening up on what it calls “lower-quality data”. The firm now insists that price information must no longer come directly from traders, with an incentive to lie or at least equivocate, but from back-office staff instead. The firm is also asking traders to reveal their counterparties—a move that many of them dislike. Its journalists also say that they are doing more to exclude questionable trades from their indices. “When in doubt,” says Michael Wilczek of Platts, “we throw it out.”

All energy trading has recently slowed sharply, thanks to lower credit ratings for power companies and to a liquidity crunch induced by revelations of accounting fiddles. However, a rising share of deals now goes through the Intercontinental Exchange (ICE), an online trading platform backed by big energy companies, which has recently grown thanks to a demand for more transparent dealing. On October 16th ICE said that it would join forces with Argus, an energy publishing firm, to provide impartial, verifiable price indices. The new company, called 10X, gets exclusive use of data on deals done on the exchange. That may not pick up the prices at which bilateral deals take place, but it at least makes the market more transparent.

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**Wall Street's independent analysts**

# Unconflicted

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**Independent research firms come into their own**

WITH the integrity of investment research at Wall Street's giant banks in grave doubt, others are profiting. One partnership that sells such research, Portales, has urged clients over the past year to sell the shares of all the big banks, all the big brokerages, and a half-dozen consumer-finance companies. Until very recently, it had a “buy” rating on, well, nothing.

Smart institutional clients increasingly direct trades to Portales, in exchange for insights. Business is booming. Even as the big investment banks cut great numbers of employees, Portales hopes to expand its coverage by adding staff. Covering financial-services companies, a Portales speciality, is an area of particular conflicting interests for the big Wall Street banks. They and insurance companies trade with one another, provide each other lines of credit, sell each other's products, and sit side-by-side to negotiate mergers. It is a fertile area for young, independent firms like Portales.

Unfortunately, Portales's hiring spree—it plans to expand staff by 63%—will bring little relief for employment in the securities industry as a whole. It aims merely to add five employees to its current eight. Pure research is not a business that needs armies. Still, Portales is not unique in pushing a business model that makes a virtue out of research that is unconflicted by investment-banking demands.

Another small firm, Creditsights, was formed two years ago and now has 13 analysts, half of whom have two decades' experience at big investment banks. The analysts cover the bond market, as well as the shares of financial-services companies. Creditsights charges $12,000 a year for its research, accessed via the Internet. Another, still smaller, firm is Gimme Credit, which dates back to 1994. It has a small administrative office on Wall Street, but two women with a background in bond analysis are at the heart of the firm, one in a Chicago suburb, the other in Chicago proper. Each day, they write incisive, single-page reports on the debt issued by two companies in the news. The reports are e-mailed to subscribers, for an annual fee of $18,000. Business for both Creditsights and Gimme Credit is on the up—Gimme Credit now has 400 or so subscribers.

Life at a small firm is very different from that at the big Wall Street houses. Portales is in the low-rent Flat Iron district of Manhattan, known better for its toy manufacturers than for finance. The firm offers no guaranteed salaries, secretaries or other office perks: everyone takes a turn collecting the rubbish. Customers, says Charles Peabody, an equity analyst who founded the firm with two others in 1997, do not expect to be entertained. Getting together with them means a monthly dinner at the office, rather than an evening at the Four Seasons or a strip club.

The likes of Portales (though not independent firms with a business model based on subscriptions) still have one thing in common with the big firms: they are rewarded murkily, through trades given to them by institutional clients rather than with straight cash for research. It is a way for institutions to keep their own dealings that bit less transparent. Letting customers, whether they are pensions or holders of mutual funds, see what they are paying for would only make them better able to judge its worth.

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Japan's banking mess

# Takenaka attacked

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## A furore before bank reforms are even unveiled

Get article background

FRESH attempts to sort out Japan's rotten banks were never going to be easy. Still, few expected that Heizo Takenaka, the new financial-affairs minister, would stumble so quickly. Just three weeks after taking on the job of overseeing the banks, and before he could even lay out his reform plan, Mr Takenaka was in trouble. His intention to propose broad measures on October 22nd for cleaning up the banks was stymied at the last minute by angry politicians in the ruling Liberal Democratic Party (LDP). They said that his proposals, which included better provisions against dud loans and tighter restrictions on bank capital, were too harsh.

The prime minister, Junichiro Koizumi, rushed to his minister's defence the following day, demanding—and getting—his cabinet's full support for Mr Takenaka. Mr Koizumi nonetheless faces battles with his party and his coalition partners. They do not like the idea of bankruptcies among banks and dud borrowers, a big source of political support. Politicians blame Mr Takenaka for rattling stockmarkets, which have fallen by over 10% since his appointment, to fresh 19-year lows. They are bitter that Mr Takenaka, a mere academic, has promised drastic reform without considering its political consequences. They also resent the private-sector folk that Mr Takenaka has chosen as his advisers.

Mr Takenaka, in fact, faces resistance from all sides. Not only do opposition parties in parliament want to censure him. People inside the Financial Services Agency, which he heads, are also trying to soften his reform proposals. The Ministry of Finance is steering clear of the whole furore, perhaps waiting for a chance to take control of the banking agenda. Even some parts of the prime minister's office are said to be working against Mr Takenaka. His proposals, after all, will greatly weaken the banks, presumably to the point where they would need injections of public money.

Critics are irritated that fresh measures to boost demand and offer better unemployment benefits and retraining have yet to materialise, even though serious bank reform would entail sweeping job losses. The government is due to announce yet another anti-deflation package, though few believe it will be any more potent than earlier ones. So far, Mr Koizumi is resisting calls for another supplementary budget to prop up the weakened economy.

Others argue, with no great difficulty, that the government's policies lack coherence. Even as the government was promising to get tough on banks and their borrowers, the Development Bank of Japan, owned by the government, was pumping yet more money into Daiei, a retailer that has come to symbolise all that is awful about those companies to whom the banks have lent.

Other bits of Mr Takenaka's reforms are also under attack. One proposal aims to introduce stricter rules to cap the amount of deferred-tax assets banks may include as tier-one capital—currently deferred tax makes up about half of such capital at big banks. Imposing a cap would send many banks' capital-adequacy ratios below the 8% level that international rules require. That would make it easier for the government to step in and inject public money into the banks. But it has raised howls from bank executives who fear that, with public money injected, they may be forced to take responsibility and resign.

Critics warn this all risks causing a severe credit crunch, as banks start reducing risk assets to raise their capital-adequacy ratios. Banks may start shrinking their loan portfolios radically as the implementation of the cap draws near, warns David Atkinson, bank analyst at Goldman Sachs. Other proposals, say to tighten provisioning requirements, lack key details.

In sum, says Eisuke Sakakibara, a professor at Keio University and former heavyweight at the finance ministry, Mr Takenaka's measures do not constitute real reform, because they fail to address the basic problem of banks' non-performing loans or their non-performing borrowers. The minister, says Mr Sakakibara, is a political amateur attempting to force through half-measures. With so many people against him, the main question seems to be by how much more Mr Takenaka's reforms will be watered down before they are acceptable.

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**Cross-border payments in euros**

# Banks play monopoly

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**Imperfect competition keeps banks' cross-border charges absurdly high**

WHY should banks still be able to charge up to *euro*43 ($42) to transfer *euro*100 from one account to another across national boundaries within the euro area? Even after the introduction of euro notes and coins in January, banks have resisted attempts to outlaw such blatant gouging of their customers. That is despite threats from the European Parliament, and a European Union directive that has required banks, since July 1st, to charge no more for cross-border transfers within the euro area than they do for transfers within their own country. So far the rule applies only to card payments and cash-machine withdrawals, but from next July it is meant to apply to all transfers.

Unfortunately, the banks have little competition in this field. There was once a hope that Internet payment schemes might bypass the bank payment system, but one by one the schemes have been squashed by banks' incumbency.

Take Earthport. It had a nice idea called Sendcash: a customer could load a virtual Internet "wallet" with euros (even in Britain or Sweden) and send them instantly to the owner of another Earthport wallet in Germany, France or wherever at a cost of 17 euro cents. There was a snag. At one end, the wallet had to be loaded from the customer's bank account to an account at Earthport's bank, which happened to be Barclays. This cost nothing, but took four working days. At the other end, the wallet had to be unloaded, via a branch of Barclays in France or Germany, by means of a bank transfer to the other customer's bank account. A random customer, actually *The Economist*'s correspondent in Frankfurt, found that it took seven working days for the transfer of *euro*15 from his Earthport wallet to Barclays in the Bockenheimer Landstrasse, and thence to his account at Citibank in the Grosse Eschenheimer Strasse. In France, another random customer found that it took at least ten working days for the *euro*25 that he downloaded from his wallet to reappear in his account at the Société Marseillaise de Crédit.

It was clumsy and time-consuming, but it avoided horrible bank charges. Unfortunately, Earthport withdrew its Sendcash service in April: it was costing too much to pay Barclays for the service. Other Internet-based methods of sending cash across borders, such as Paybox and PayPal, are just as cumbersome, but they do not avoid heavy bank charges.

So will euros ever travel friction-free across the euro area? Debit cards already ensure it, with careful cash-priming, but the cash flows only one way. A debit cardholder can withdraw cash, often without cost, at an ATM cashpoint in one euro country, from his euro bank account in another—but only up to an agreed maximum, of perhaps *euro*500 a day. A Parisian father can supply cash to his student daughter in Milan, if she has a bank card, by topping up her home bank account.

"Don't use a bank credit transfer for small amounts," says Patrick Poncelet, head of payment systems at the European Banking Federation in Brussels, but he admits that banks have little incentive to point their customers to cards instead. For banks, the EU directive came too early. All banks use their nation's automated clearing house for low-value payments, so even in the euro area crossing borders means extra expense. A study of cross-border payments published in 2001 showed a range of cross-border charges for transferring *euro*100, from *euro*6.20 to *euro*43.40, depending on the banks involved and the country. Transfers took an average of 3.3 days.

The EU directive demands that charges be no higher for cross-border transfers than for domestic ones, but it does not stipulate price. An earlier directive, on the other hand, sets a time limit for transfers—six days, which was not met last year in 6% of cases. Several initiatives set out to improve payment systems, most of them cleverly led by the banks themselves. The European Payments Council, backed by over 40 European banks, published a paper in May, mapping out how they will approach the problem. (It

could not resist putting a price tag on the paper of *euro*400, which hardly ensures a wide audience.)

One proposal is for a pan-European automated clearing house for low-value payments, to be run by the Euro Banking Association, which already has a system for large-value payments in euros. Creating such a clearing house is not difficult, says the deputy chairman of the association, Eric Sepkes: the challenge is to persuade all European banks to use the same payments messaging system. Britain's banks may be the hardest of all to persuade. They are spending heavily on developing a new British automated payments system regardless of developments in the euro area. That is surely a signal that they do not expect to join the single currency anytime soon.

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**Southern Africa's customs union**

# Led by example

Oct 24th 2002 | JOHANNESBURG
From The Economist print edition

**Better a small success than a big flop**

GRAND plans for African economic recovery have never worked. The latest, the New Partnership for Africa's Development, or Nepad, seeks wholesale change, the end of wars, better governments and a surge of foreign and local investment. All nice ideas, and some leaders such as South Africa's Thabo Mbeki are serious about them. But too many others, from Libya's Muammar Qaddafi to Zimbabwe's Robert Mugabe, are not. So how to make progress? Mr Mbeki could instead look for small, concrete economic successes nearer home, and celebrate those.

This week five southern African countries agreed a revised customs treaty that should deepen the integration of southern African economies. On October 21st the heads of state of South Africa, Botswana, Namibia, Lesotho and Swaziland signed an accord rejigging the rules of the Southern African Customs Union (SACU). No earth-shattering deal, this. The union is the world's oldest, formed in 1910, and needed sprucing up. A new administration, along with clearer rules on shared tariffs and on how to co-ordinate trade policies, is the sort of predictable and business-friendly progress that Africa badly needs.

The union consolidates a free-trade area among 50m better-off Africans. It lets lorries cross its members' borders with minimal paperwork. Meanwhile, governments speak with one voice at trade talks. SACU has a completely open market, so member countries must co-ordinate everything from macroeconomic policy to competition law. South Africa's rand is, in effect, the common currency, with interest-rate changes in Pretoria instantly followed by central banks in the other four capitals. “We will not”, says Tshediso Matona of South Africa's trade and industry department, “be the European Union tomorrow. But we are driven by the same processes.”

Yet the customs union is putting its old self out of business. Led by South Africa, it is cutting tariffs on imports, as free-trade deals with the European Union and elsewhere come into force. That means governments must find new ways to raise revenue, for example, from income and sales taxes. In time, a broader source of revenue should strengthen the states, while lower tariffs should free the movement of goods and services, and may tempt a few more investors. SACU's small successes could be a lesson for the rest of Africa.

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Money-laundering

# Shell games

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**The Financial Action Task Force tries to crack down on abuse of corporate vehicles**

Get article background

IF YOU open an account at a reputable bank these days, the teller will demand various pieces of identification and perhaps, if you look unusual, file a “suspicious transaction report” to the authorities. For a money-launderer or a sophisticated terrorist organisation, on the other hand, there are plenty of ways to slip through the barriers put in place by financial institutions since September 11th last year. Rather than go into a bank as an individual, a criminal can enter the system behind a corporate mask. All he needs to do is set up a company in a place that does not require the owner's identity to be revealed; with it, he can, in effect, open an anonymous account.

A British government report in 2000 said that almost all big money-laundering operations in Britain involved shell companies. In Britain, America and many other places, it is an easy matter to set up companies overnight, giving little or no information to anyone except to company-formation agents, who offer registered offices and other services. After complaining about the problem for years, the world's main body tackling money-laundering, the Financial Action Task Force, is preparing to do something about it. It has published a consultation paper with new rules on corporate vehicles, to be discussed and agreed by its 29 mostly rich-country members by June next year.

The most far-reaching and costly of the task force's proposals is that its member countries change their corporate law so that companies whose shares are not publicly traded must identify their beneficial owners. Most controversially, the task force suggests that its members eliminate bearer shares, that is, paper certificates that give anonymous ownership of a company to the person in possession of them. Also, it says, banks should be obliged to discover who owns their corporate clients; and that trusts, all of which are private agreements in which one person controls property for the benefit of another, should register the names of their trustees, settlors, protectors and beneficiaries.

Despite the task force's determination, the effort to close this hole in the world's defences against money-laundering is unlikely to go far. Austria, Belgium, Germany and Switzerland will fight for their bearer shares, which they say have legitimate purposes even though they confer anonymity. As for America and Britain, both say that registering trusts is out of the question. Britain's Treasury wants to make all private and unlisted public companies reveal their beneficial owners at Companies House, the public register. Yet the plan is likely to founder, says an official, because of opposition from businesses and from the Department of Trade and Industry.

The countries that will most resent the task force's initiative are not its members, but those that look and smell like offshore tax havens. Big countries, such as the United States, will insist that their existing systems are good enough: their investigators can, if need be, find out who owns a company. Yet the task force is likely to decide that small jurisdictions need to adhere to higher standards on corporate vehicles than those of big countries because, for one thing, a greater proportion of vehicles is owned by non-residents than is the case in larger economies.

Tax havens would (reasonably) object to this unequal treatment. Many large countries have incorporation rules that are laxer than theirs, they say. A recent report by the Society of Trust and Estate Practitioners, a trade body, says that according to the law in the state of Delaware, not even company-formation agents have to know who the beneficial owners of a limited liability company are. A study in 2000 by America's General Accounting Office concluded that it is easy for foreign entities to hide their identities in Delaware shell corporations and launder money.

Senator Carl Levin of Michigan, who asked for the report, said at the time that, although America criticises other countries for allowing the creation of corporations with secret ownership, “we are basically doing the same thing.” If the task force's efforts are to have much effect, it will need to tackle not just the usual, island suspects, but also some of its most powerful members.

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Neutrino astronomy

# Deep and meaningful

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**In some cases, the best place from which to admire the heavens is the seabed**

ASTRONOMERS usually look up. But some astronomy is better conducted by looking down. Although the earth is opaque to the light, radio waves, X-rays, gamma rays and other forms of electromagnetic radiation that are the stock-in-trade of most astronomy, it is transparent to particles called neutrinos. Point a suitable telescope downwards, therefore, and the chances are that you will see nothing but neutrinos. Sink it deep under water, and you will get an even better view, since the water will help to screen out confusing radiation coming from above.

This, at least, is the theory behind two rival machines being built at the bottom of the Mediterranean. Both NESTOR and ANTARES will look for high-energy neutrinos, a little-studied form of radiation. These telescopes should give a glimpse of hot, dense regions of space that cannot now be examined because they absorb electromagnetic radiation at all wavelengths. That will be interesting, but not spectacular. With luck, though, NESTOR and ANTARES will also reveal the first evidence of a form of matter called weakly interacting massive particles (WIMPs). That would rewrite understanding of the universe.

Many physicists believe that WIMPs make up much of the universe's “dark matter”. This is stuff that shows up because of its gravitational effect, but has otherwise been undetectable. If WIMPs exist, theory predicts that they contribute about ten times as much mass to the universe as the protons, neutrons and electrons of which familiar “normal” matter is made. If that is true, then planets, stars, galaxies and, indeed, people, are just scum floating on a sea of WIMPs.

## Playing hard to get

The NESTOR telescope is the more advanced of the two projects. If the weather co-operates, it should go live in November. It will be located 4km below the surface, off the coast of Greece. The detector elements of the telescope will be mounted on towers 330 metres tall. Eventually, there will be seven towers, spread over an area of just under a tenth of a square kilometre. NESTOR was originally a collaboration between Greek and Russian scientists, although four other countries, including America, are now involved.

ANTARES is a collaboration between researchers from seven European countries. It is being built off the coast of France, at a depth of 2½km. The individual detectors will be attached to ten strings, each 400 metres long, and each fixed to the seabed at one end and to a buoy at the other. This array, too, will

have an area of a tenth of a square kilometre. If all goes well, the first string will be activated in December.

The detectors in NESTOR and ANTARES cannot “see” neutrinos directly. Instead, they are sensitive to light. The sort of light they are looking for is called Cherenkov radiation. It is produced when something travels through a medium at greater than the speed of light in that medium. (This does not violate the idea that nothing can travel faster than light, because the upper limit applies to the speed of light in a vacuum; light slows down when it passes through matter.) Cherenkov radiation is not produced by neutrinos themselves. But occasionally a neutrino reacts with an atom to create a particle called a muon. And muons can generate Cherenkov light.

In the case of NESTOR and ANTARES, the water of the Mediterranean has a second role, besides screening out radiation from above. It acts as the medium in which Cherenkov radiation is generated. Muons created by low-energy neutrinos produce only small amounts of Cherenkov radiation. Most low-energy neutrinos that arrive on earth come from the sun. They are already studied by smaller neutrino telescopes located in mines, and can thus be ignored. High-energy neutrinos, of the sort created in cosmic calamities such as supernovae, result in high-energy muons. These create large amounts of Cherenkov radiation, and can be identified because they trigger several widely spaced detectors.

The distribution of the detectors triggered allows the direction of the Cherenkov radiation, and therefore the flight direction of the muon, to be worked out. That gives the path of the original neutrino. Those from below the telescope can be traced to their sources in space. Signals from above the telescope can be identified and ignored. Some of these may be the result of muons created by neutrinos from space, but most will be from muons created in the atmosphere by cosmic rays.

One source of high-energy neutrinos is likely to be supernova remnants, such as the Crab Nebula. These are thought to be the sources of cosmic rays, which are high-velocity charged particles (mainly protons) that constantly bombard the earth. Observing neutrinos from supernova remnants would confirm this suggestion, since neutrinos of the right energy would be signs of protons being accelerated to the speeds of cosmic rays.

What everyone is really hoping for, though, is evidence of WIMPs. And this is another reason for pointing the telescopes downwards, because WIMPs, if they exist, would be heavy (at least in sub-atomic terms). That means they would accumulate in the centres of massive bodies such as the earth. And WIMPs should have another peculiarity. This is that they would simultaneously be matter and antimatter. In other words, if two WIMPs met (which should happen quite frequently in the centre of the earth) they would annihilate one another. Such annihilations would generate tell-tale neutrinos, indirectly revealing the reality of WIMPs.

The principle of underwater neutrino detection has already been tested in a small experiment at Lake Baikal in Siberia, so it is known to work. It has also been tried (albeit that the water in question was frozen) by putting detectors down a hole at the South Pole. But it is not foolproof. A previous attempt to build a decent-sized neutrino telescope under the sea, near Hawaii, ended when the detectors leaked.

So it remains to be seen which, if either, of the new telescopes will win the prizes. The feeling among neutrino researchers is that the $20m cost of completing each telescope means there will, in the end, be money enough to finish only one of them. NESTOR is reckoned to be less financially secure than ANTARES, but it should have the advantage of going live first. Whichever comes out on top, though, it is clear that astronomers believe there is treasure to be found at the bottom of the sea.

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Gamma-ray astronomy

# Integral observations

Oct 24th 2002
From The Economist print edition

**A new gamma-ray telescope has just been launched**

**Gamma plus**

ASTRONOMERS like to have as many windows on the universe as possible. That is why they are interested in high-energy neutrinos (see article). But since June 2000, when a satellite called *Compton* met a fiery end in the earth's atmosphere, they have been able to see less clearly than they would wish through quite an important window—the one labelled “gamma rays”.

Gamma rays are high-frequency electromagnetic radiation—essentially, extremely energetic light. They are produced by supernovae, neutron stars, galactic centres, black holes and the like. But they are particularly associated with events called gamma-ray bursts, which are the biggest explosions yet detected in the universe—brighter than a billion suns. Until 1997, no one even knew how far away these explosions were. They are now thought to happen in the most distant galaxies known. But there is still controversy about what causes them, and that will not be resolved until the gamma-ray window is clear again.

On October 17th, therefore, a Russian Proton rocket took off with a window cleaner on board. INTEGRAL, the International Gamma Ray Astrophysics Laboratory, was designed by the European Space Agency to replace *Compton*. Indeed, it will be better. Gamma rays have to be studied from space because they cannot penetrate the earth's atmosphere. But gamma-ray telescopes are also confused by charged particles trapped in the earth's magnetic field. INTEGRAL will therefore be given an eccentric orbit—spending 90% of its time more than 40,000km from earth, well away from that field's influence. This is much farther than any of its predecessors ventured, so it should have a clearer view.

Its eccentric orbit also means that INTEGRAL takes 72 hours to travel round the earth, allowing it to fix its gaze on a single target for a substantial length of time, and thus gather more and better data than those predecessors. And, of course, technological advances since *Compton* was launched 11 years ago mean its instruments are more sensitive. Whether all this will allow it to solve the gamma-ray-burst problem remains to be seen. But it will also work on a host of subsidiary questions. Not least of these is the chemical composition of supernova remnants. This may seem esoteric, but it is also fundamental. A lot of the atoms of which the earth is made were themselves made in supernovae.

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Computers in schools

# Pass the chalk

Oct 24th 2002
From The Economist print edition

## Not helpful

AP

But they're fun

BACK in 1922, Thomas Edison predicted that “the motion picture is destined to revolutionise our educational system and...in a few years it will supplant largely, if not entirely, the use of textbooks.” Well, we all make mistakes. But at least Edison did not squander vast quantities of public money on installing cinema screens in schools around the country.

With computers, the story has been different. Many governments have packed them into schools, convinced that their presence would improve the pace and efficiency of learning. Large numbers of studies, some more academically respectable than others, have purported to show that computers help children to learn. Now, however, a study that compares classes with computers against similar classes without them casts doubt on that view.

In the current *Economic Journal*, Joshua Angrist of the Massachusetts Institute of Technology and Victor Lavy of the Hebrew University of Jerusalem look at a scheme which put computers into many of Israel's primary and middle schools in the mid-1990s. Dr Angrist and Dr Lavy compare the test scores for maths and Hebrew achieved by children in the fourth and eighth grades (ie, aged about nine and 13) in schools with and without computers. They also asked the classes' teachers how they used various teaching materials, such as Xeroxed worksheets and, of course, computer programs.

The researchers found that the Israeli scheme had much less effect on teaching methods in middle schools than in elementary schools. It also found no evidence that the use of computers improved children's test scores. In fact, it found the reverse. In the case of the maths scores of fourth-graders, there was a consistently negative relationship between computer use and test scores.

The authors offer three possible explanations of why this might be. First, the introduction of computers into classrooms might have gobbled up cash that would otherwise have paid for other aspects of education. But that is unlikely in this case since the money for the programme came from the national lottery, and the study found no significant change in teaching resources, methods or training in schools that acquired computers through the scheme.

A second possibility is that the transition to using computers in instruction takes time to have an effect. Maybe, say the authors, but the schools surveyed had been using the scheme's computers for a full school year. That was enough for the new computers to have had a large (and apparently malign) influence on fourth-grade maths scores. The third explanation is the simplest: that the use of computers in teaching is no better (and perhaps worse) than other teaching methods.

The bottom line, says Dr Angrist, is that “the costs are clear-cut and the benefits are murky.” The burden of proof now lies with the promoters of classroom computers. And the only reliable way to make their case is, surely, to conduct a proper study, with children randomly allocated to teachers who use computers and teachers who use other methods, including the cheapest of all: chalk and talk.

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Optoelectronics

# Feeling flat

Oct 24th 2002
From The Economist print edition

**A way to bridge the gap between light and electrons is starting to emerge**

WHEN Edwin Abbott Abbott set “Flatland”, a satire on Victorian society, in a two-dimensional universe, it was not meant as a compliment. In Abbott Abbott's geometrical romance, enlightenment comes to the hero, Mr Square, from his understanding of the nature of a third dimension. More dimensions, it seems, are better than less.

Yet, when it comes to building circuits with light, the failure of photons (the particles of which light is composed) to squeeze into flatness has made them less, not more, useful. Electronic chips are essentially two-dimensional, the electrons being confined to conductive and semiconductive layers laid down on a chip's surface. Engineers would like to be able to build chips in which photons and electrons can have meaningful interactions, since that would permit better ways of handling data.

But photons are more wayward than electrons. Although ingenious methods have been developed to corral them into something approaching two dimensions (tiny fibre-optic waveguides, mirrors, diffraction gratings and so on) these components are still so big compared with their electronic cousins that building “optoelectronic” chips for general use is rare. At the moment, such optoelectronic chips as exist are made of unusual materials, using unconventional processes, and are restricted to specialised applications.

A significant step towards properly integrated optoelectronics has now, however, been made. Joachim Krenn, of the Institute for Experimental Physics in Graz, Austria, and his colleagues, have been experimenting with inelegantly named packets of energy known as surface plasmon polaritons (SPPs). These are neither photons nor electrons, but they rely on both for their existence, and may thus provide a way of bridging the gap.

An SPP forms at the junction between a dielectric (non-conducting) material and a metal. Electrons in a metal are free to oscillate when light hits them. This is why metals are shiny. At a dielectric/metal junction, though, that oscillation is confined, since it cannot spill over into the dielectric material. However, it can still move sideways, being passed from electron to electron as a wave. Moreover, the energy is restricted to those areas that are made of metal. The techniques used to craft chips mean that such areas can be made minute. This, in turn, means that energy from light can be squeezed, via an SPP, into structures the same size as those used to channel electrons.

That energy, and thus the data carried by it, can also be processed. Because SPP propagation takes place entirely between the metallic and dielectric layers, it is sensitive to changes in the junction between the two. This means that components equivalent to those in electronic circuits can be constructed from appropriate patterns of bumps in the junction. Using this technique, Dr Krenn and his colleagues have been able to build many of the types of component needed to handle data encoded in the form of SPPs.

That is all very well, but it would be even better if it were possible to transfer SPP-borne data to electrons, for processing by more conventional components, and back into photons. Bill Barnes, a physicist at the University of Exeter, in England, is trying to do just that. He is looking for materials that are sensitive to the passage of polaritons. He has already discovered some that fluoresce in response to SPPs. However, what he really wants to find is a substance that will change state semi-permanently when an SPP passes by. In particular, he would like to discover one in which the change is from a conductor to a dielectric, or *vice versa*. That would allow SPPs to throw switches in electronic circuitry, completing the link between optical and electronic data. And that would really get optoelectronics going.

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**Princely collecting**

# At home with the Gonzagas

Oct 24th 2002 | MANTUA
From The Economist print edition

**One art show absolutely not to miss this autumn**

THE next time you wander through the national gallery of any world capital, spare a thought for the Gonzaga dynasty, for they began the princely pursuit we now call art collecting. It was they who built the world's first picture gallery, indeed its first museum, to show off their family treasures at the ducal palace in Mantua. Beginning with Lodovico in the mid-15th century, six generations of Gonzagas acquired the greatest art of their age. Artists and admirers flocked to their court until the last duke, a bankrupt, sold the best of his collection to Charles I of England. What the British monarch left behind was destroyed or dispersed when Spanish imperial troops sacked the city two years later, in 1630. All that remained was a legend and a looted palace.

Until now. A once-in-a-lifetime exhibition has set out to reconstruct the Gonzaga collections and display them as they once were in Mantua. The show recreates a suite of galleries like the original ones: paintings, sculptures and decorative objects jostle each other just as they did when Ferdinando Gonzaga organised his family collections, built up over 150 years, into a museum around 1620. The 215 works on show represent a glittering sample of the entire collection, which numbered at its peak over 2,000 paintings and 20,000 sculptures and treasures.

Earlier shows have invoked the Gonzaga mystique, notably “Splendours of the Gonzaga” in Britain in 1981. However, this one is unique in its attempt to reconstruct the collection as a whole—it was almost an artwork on its own—and then to display a representative selection in its proper setting. Though this approach is intrinsically more interesting than a rollcall of masterpieces, it was also born of necessity: works such as Caravaggio's “Death of the Virgin” in the Louvre and Van Eyck's “Man in a Turban” in London's National Gallery are seldom permitted to travel.

The show's guiding aim is to grasp the Gonzagas as collectors, to enter into their heads, as the co-curator Raffaella Morselli puts it, by taking us back to the mentality of these princes and their age. For every painting that has become an icon of art history, we see a dozen works by lesser-known artists whom they adored, such as Domenico Fetti and the female painters Sophonisba Anguissola and Lavinia Fontana. We get a sense of the Gonzagas' tastes, which veered more to the bizarre than to the sacred: they loved dwarves and donkeys, treating the one as pets and using the other for a locally prized stew.

Ms Morselli, a professor specialising in Bolognese painting, and Andrea Emiliani of the Bologna Pinacoteca have worked for the past five years on a detective mission to gather the scattered art of the Gonzagas from across the world. The Rosetta stone of the Gonzaga collections and the key to this exhibition was the inventory compiled by Duke Ferdinando in 1626-27, just before his death. Luckily for the scholars,

Ferdinando was methodical. He grouped the family collections in different galleries: one for the Olympians of the 1500s—Correggio, Mantegna, Giulio Romano, Tintoretto, Titian; another for the great art of his day that included the baroque artists Guido Reni, Guercino and Domenichino; a third gallery for family portraits including Isabella d'Este and her son Federico by Titian, and Maria de' Medici by Rubens.

## The personal touch

Ferdinando's private apartments revealed his own tastes and personality. He avoided famous names, save for Titian's intimate “Lady with a Mirror” and Mantegna's sombre, foreshortened “Dead Christ”, which hangs near Quentin Metsys's portrait of Erasmus, intended as a gift for Sir Thomas More. Instead he concentrated on what he called variety and manner: we see Hoefnagel's curious paintings of parrots next to Lavinia Fontana's extraordinary painting of a hirsute girl, her face covered in fur while the rest of her body is clothed in an elegant court dress.

In and among the paintings, we see expensive decorative pieces of the kind that separated the men from the goats among contemporary collectors: ceremonial armour painted by Raphael, dozens of bronze and ancient sculptures, gold reliquaries and incunabula, rock crystal vessels, cameos and jewels. The show abounds too in works newly found to have been in the Gonzaga collection: the Tintoretto from the Fogg Art Museum at Harvard has just been traced to the Gonzagas. From a museum in Arras, Ms Morselli borrowed Baglione's life-size paintings of Apollo and the muses, which hung in the Room of the Muses, where composers performed their latest works. This room has been recreated, complete with piped-in strains of Monteverdi: the Gonzagas were also among the world's first opera patrons.

Shows of this kind routinely dazzle sponsors with impressive-sounding advisory committees naming virtually every scholar in the field. So it is here, with a roster of no less than 60. One of them deserves special mention: the late Francis Haskell, who pioneered the modern study of taste and patronage, and who could be called the intellectual godfather of the collector-and-collection show.

## Avoid the weekend

The exhibition takes place not where the works were housed—in Mantua's ducal palace, which lacks the necessary air-conditioning and security—but in the nearby Palazzo Te, the villa commissioned by Federico Gonzaga to entertain his mistress, designed with famously odd architectural features and decorated with stupendous frescoes by Romano. Unfortunately, the halls of this mannerist wonder are too cramped for the 100,000 visitors crowding in monthly. Art lovers are advised to avoid weekends (when you can see only other visitors' heads), and to visit the ducal palace first (where you can see Mantegna's frescoes in the Camera degli Sposi and other marvels) to get a sense of how the Gonzagas lived.

The Gonzagas were the most avant-garde collectors of their age in Ms Morselli's view and her show goes far towards making good the claim. Collectors such as the Medici used art to promote the local glories of Florence, the Gonzagas set out to rival kings on an international scale. They courted artists, rather than pressuring them to paint at their court. Although the Gonzagas' dynastic ambitions ruined them, their collecting set a European standard for two centuries.

The dukes of Mantua were no more lovable or attractive than other princes of their Machiavellian age. They were often brutal and on occasion fratricidal. But, as this magnificent show confirms, they understood a simple truth: great art makes you immortal.

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“Gonzaga: La Celeste Galeria” is at the Palazzo Te in Mantua until December 8th 2002, from 9am to 7pm daily. For tickets (in Italy): freephone 800.11.22.11; or (from abroad) +39-0577-223806. Web: www.mostragonzaga.it

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About sponsorship

Englishness

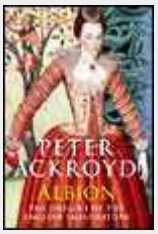
# This little world, this precious stone

Oct 24th 2002
From The Economist print edition

WHAT is Englishness, and in what does it consist? Some will see it in the line of the Malvern hills, or hear it in the patter of rain on oak leaves. Some will trace it in a self-effacing gesture, an embarrassed laugh, or the silence of travellers on the London Underground. Others will find it in Charles Dickens's descriptions, in William Blake's engravings or in the rude little figures in the margins of the Luttrell Psalter. Peter Ackroyd finds it here, there and everywhere.

His magisterial study of the theme is at once absorbing and frustrating. It is slow reading, not only because the text is stuffed and encrusted with references and quotations, but because any self-respecting reader has to argue with him the whole way. The English, he claims, love surface decoration and intricate patterns rather than profundity, a predilection that extends through the plastic arts to music and philosophy. So has nothing profound come out of England? And what is one to make of the patent love of decoration seen in other cultures? Ah—Mr Ackroyd will say—he cannot deny that other cultures feel the same way. But to the degree the English share with, or borrow from, other peoples, that itself is a mark of Englishness: heterogeneity, easy borrowing, mongrelism. The reader can't win.

Albion: The Origins of the English Imagination
By Peter Ackroyd




*Chatto & Windus; 516 pages; £25*

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Mr Ackroyd makes much, rightly, of the beauty and adaptability of the English language itself. His book, as befits a writer, is mostly about literature, with short and unsatisfactory excursions into paintings, music and architecture. The native genius lies in the language, and he traces both well and enjoyably the survival, despite the assault of Latinisms and baroqueries from the 16th century onwards, of the plangent alliterative line of the Anglo-Saxons. From there, it is a short step to tracing the sound and influence of the sea. Mr Ackroyd, with his ear for English melancholy, surely makes less of the sea than he might have; foreigners have often thought the ceaseless surrounding waters, with their mists and sighs, are the key to the English character. But the sea gets no more than its short allotted chapter, and the very English phenomenon of the seaside no mention at all.

Instead, a good portion of the book centres on London. Here Mr Ackroyd should really declare an interest. His “London: The Biography” (2000) proved him one of the best writers on the city for a long time, and his deep knowledge of it has illuminated all his work. But London's predominance here is more questionable. In its variety, its superficiality, its solitary night walkers and its jumbled juxtaposition of public and private spaces, you could argue that it is the beating heart of Englishness. But, like any world city, it teems with influences that have nothing uniquely to do with the native character. Oddly, Mr Ackroyd is most convincing when out among the hills and woods, just as the cockney Turner found his inspiration when strapped to the mast of a ship in a storm.

Some of Mr Ackroyd's theories of Englishness are intriguing. He finds, for example, a sadness for the vanished Catholic past lurking in the keen antiquarianism and the almost obsessive rediscovery of old modes of expression. Piety, and a sense of God's special favour hovering over England, are, he believes, constants in the English character—which raises the question of where they have gone now. Another theme is the serpentine “line of beauty”, which Mr Ackroyd, stretching that line extremely far, discovers in church columns, polyphony, the pregnant female form and the long, well-worn horizons of the English landscape. Straightness and abstraction, he insists—ignoring countless scientists and thinkers starting with Newton and Locke—are not English, any more than lofty theorising is: Englishness is about muddle, practical experiment, miniaturising and embarrassed detachment from the act of creation in all its forms.

If he is right, “Albion” itself is a thoroughly un-English enterprise: a quasi-encyclopedia of facts linked

with lofty theorising of just the sort that bluff Englishmen have always spoofed or dismissed with a phrase and a fart. Fascinating as the book often is, Mr Ackroyd's real interest sometimes seems to lie elsewhere. Strangely prominent here is the ghostly figure of William Langland, the 14th-century author of “Piers Plowman”, walking along Cornhill in London with his shaved head and his tattered coat. Mr Ackroyd might have done better if, with an English love of the miniature and the biographical, he had traced the nature of the English imagination through this one particular life.

Albion: The Origins of the English Imagination.
By Peter Ackroyd.
*Chatto & Windus; 516 pages; £25*

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**Regulating Wall Street**

# An overseer's apology

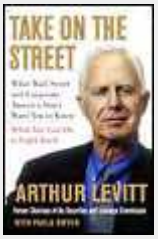
Oct 24th 2002
From The Economist print edition

THE regulator's job, like the undertaker's, is best done out of the spotlight. There are many reasons for this, not least that most regulation is both arcane and dull. But another is that, though regulators need to avoid capture by their charges, they must also not be too confrontational. It is better to work with the grain of an industry than to have blazing rows with it.

So it was with America's most powerful financial regulator, the Securities and Exchange Commission (SEC)—until recently. But today's SEC chairman, Harvey Pitt, is under attack from investors bruised by the bear market, for being too soft. He is responding with threats to restructure not just the accountants, who missed too many cases of corporate malfeasance, but all of Wall Street, which is said to have been robbing investors blind.

If Mr Pitt, a sharp lawyer who resembles a cuddly teddy bear, is bemused by this, he could do worse than read this engaging memoir by his predecessor. Arthur Levitt was the longest-serving chairman of the SEC ever, occupying the post from 1993 to 2001. His book seeks to do two things: to educate the average investor; and to justify his years in charge. In the first aim, it succeeds admirably. Any new investor will benefit from this simple course in how the market works, the case for diversifying investments, how to read the accounts, why not to trust investment research and how to save for retirement.

Take on the Street: What Wall Street and Corporate America Don't Want You to Know
By Arthur Levitt




*Pantheon Books; 293 pages; $24.95*

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But the meat is Mr Levitt's defence of his own record. Although a Wall Street insider, he fought for the small investor. His exposé of the bad behaviour and conflicts of interest that beset investment banks, stock exchanges and company bosses is devastating. Mr Levitt first questioned the quality of auditing long before Enron imploded. He wanted to account properly for stock options, just as he wanted it known that research analysts were paid not for their predictive record but for how much investment-banking business they won.

If the system was so weak, why did he not change it? His answer is simple: he tried, but was obstructed by special interests operating on Capitol Hill. His tales of congressional lobbying by banks and accounting firms, backed by huge campaign contributions, are sobering to believers in American democracy. It is especially galling to find that some who now rail most loudly against the wickedness of Wall Street were blocking reforms during the bubble years of the 1990s.

Behind all that lurks a bigger issue that Mr Levitt largely skirts: the bubble itself. The biggest losses to investors were not from fraud or deceit, but from their own credulous belief that share prices would go on rising to unheard-of heights. What were the SEC, the Clinton administration and the Federal Reserve doing to stop this madness? A few, including Mr Levitt and the Fed's Alan Greenspan, uttered muted warnings. They should have been shouting. Sadly it will take some investors years to regain their trust in stockmarkets.

Take on the Street: What Wall Street and Corporate America Don't Want You to Know.
By Arthur Levitt.
*Pantheon Books; 293 pages; $24.95*

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**Sport-utility vehicles**

# Not as they look

Oct 24th 2002
From The Economist print edition

IF YOU like to drive, the success of the sport-utility vehicle (SUV), otherwise known as 4x4s or off-roaders, needs explaining. Lumbering and heavy, despite their engine power, they are no fun to handle. There are plenty of better road cars on which would-be Fangios or Schumachers with $50,000 or more to spare can indulge their fantasies. No, dreams of speed are beside the point when accounting for the appeal of SUVs. What they really offer is a sense of unbreachable protection from other drivers: the SUV is meant to make you and your family feel secure.

The cynical or the socially envious will take that to mean a feeling of protection from the *hoi polloi*, including the many of us who drive feeble regular cars. Sensing this, the *New Yorker* developed a genre of SUV cartoons that mocked owners for brash and conformist pretension. After all there is something comic about farm vehicles in cities delivering small girls in straw hats to the doors of their day schools.

But SUVs long ago ceased to be exclusive and social satire is not the approach of Keith Bradsher, a former bureau chief for the *New York Times* in Detroit. The problem with SUVs, he tells us, is that they are not especially safe, either for others or for their owners. Crash tests and accident statistics, he tells us, indicate that these Jeep-derived vehicles have a kill rate at least three times higher than cars. Poor driving dynamics make them liable to roll over: around 12,000 Americans were killed in SUV roll-overs during the 1990s, and the year 2000 alone accounted for another 2,049.

As a one-time observer of Motown from close to, Mr Bradsher writes in the tradition of Ralph Nader's consumerist classic, “Unsafe at Any Speed” (1965). He has a wide range of contacts in the business, including auto executives, engineers and sales people, a background giving weight to what could easily have become a polemic. He gives a comprehensive account of how lobbying by car companies, car dealers and the autoworkers' union blocked attempts to impose environmental and safety regulations on SUVs.

High and Mighty: SUVs: The World's Most Dangerous Vehicles and How They Got That Way.
By Keith Bradsher.
*PublicAffairs; 464 pages; $28*
*PublicAffairs; 464 pages; £18.99*

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New fiction

# Worth the wait, but not in gold

Oct 24th 2002
From The Economist print edition

**Ten years ago came an astounding first novel. How does the second compare?**

EVEN before it was published, with a whopping initial print run of 300,000 in America alone, Donna Tartt's new novel was talked of as a “To Kill a Mockingbird” for our times. That a publisher should be so lucky. Harper Lee's slim Pulitzer-prize winning novel about racial injustice was picked up by three American book clubs almost as soon as it came out in the summer of 1960. Although the story was set in the 1930s, the gathering civil-rights storm gave it a critical contemporary resonance. In its first year, “To Kill a Mockingbird” sold 2.5m copies. By the time its second anniversary rolled around, it had been on the American bestseller lists for 100 weeks.

The Little Friend
By Donna Tartt

*Knopf; 555 pages; $26.*
*Bloomsbury; £16.99*

Buy it at
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It is easy to see why the two novels should be compared. Indeed the pairing looks irresistible. Like Ms Lee's, Ms Tartt's novel is set in the deep South, though some might argue that Mississippi isn't all that much like Alabama. Both books have a young girl as the heroine seeking justice; both girls are trailed by a side-kick, a boy, and both begin with a murder. But the differences between them are equally, if not more, important.

Where “To Kill a Mockingbird” burst into public consciousness from an unknown novelist, Ms Tartt is already famous. She owes her renown to her first and, until now, only novel, “The Secret History”, published ten years ago. Set in a Vermont university, that book told the story of a cabal of precocious classics students who inadvertently murder a farmer while taking part in a Dionysian ritual, and then turn on one of their own when he threatens to reveal their guilt. A taut page-turning thriller that weaves together themes of youthful affectation and intellectual arrogance, guilt and moral retribution, “The Secret History” was hailed as a glittering literary debut. It went on to sell millions.

Success put pressure on the author to deliver a second novel of equal weight and selling power. The rumour was that, like Joseph Heller, she had a bad case of writer's block or had succumbed to the truth of F. Scott Fitzgerald's crack that there are no second acts in American lives. Reading “The Little Friend”, it is easy to see why she took her time.

The murder with which the book opens is that of a nine-year-old boy, Robin Cleve Dufresnes, the only son of a southern family of numberless female relatives who like to drink home-made lemonade. Robin's body was found hanging from a tree in his own backyard. Twelve years later, his sister, Harriet, less than a year old when the murder happened, vows to avenge his death. She draws on whispers, rumours and her own vivid imagination, and concludes that the killer is none other than one of Robin's school friends, Danny.

In contrast to Harriet's genteel relatives, Danny is the son of a family of habitual criminals, crazy, hardened boys who live with an adoring (and even crazier) grandmother, manufacturing methamphetamine sulphate in a squalid trailer. Harriet, who is a strange and steely creature, “sturdily built, like a small badger, with round cheeks, a sharp nose, black hair bobbed short” with a “thin, determined little mouth”, sets out to bring Danny to justice.

“The Secret History” took place on the small, tight stage of a university campus, but the world that Ms Tartt explores in “The Little Friend” is broader, more amorphous and far more frightening. While Ms Lee's Scout was, at nine, still definitely a child, Ms Tartt's 12-and-a-half-year-old Harriet is caught in that strange abrasion between childhood and adulthood. All of which enables Ms Tartt to make a rich study of

race, class and family with a sprawling cast of characters: maiden aunts, an oily Baptist deacon, car salesmen, pool-hall hustlers and the black help that function just as easily as surrogate family or helpful, tidy ghosts.

Tension created in a somnolent setting is key to how this novel works. But the book is not without problems. Where Ms Lee's main concern was with justice, “The Little Friend” is more about vengeance. Her character's moral vacuum helps deepen the sense of a child treading water between the firm ground of childhood and the adult deep, but its ramifications are, in the end, curiously little explored. This may be because, between the book's grand dramatic scenes, long passages meander without direction. Some of the best writing brings to life the brittle madness of being on drugs. But you need to read through 500 pages before you reach the best work. At half the length, “To Kill a Mockingbird” packed twice the punch.

The Little Friend.
By Donna Tartt.
*Knopf; 555 pages; $26.*
*Bloomsbury; £16.99*

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**The Man Booker prize**

# Fabulous

Oct 24th 2002
From The Economist print edition

### In the same boat

IN AWARDING Yann Martel, a Canadian, this year's £50,000 prize for “Life of Pi”, the Man Booker judges chose one of the strangest but most approachable novels in years. Pi (for Piscine), a 16-year-old boy, emigrates to Canada with animals from a zoo his father ran in India. The ship sinks in the Pacific and Pi finds himself in a lifeboat with only a Bengal tiger for company. The journey tests Pi's faith in himself, not to mention his faith in God. “Life of Pi”, which mixes yarn, fable and morality tale with musings about religious conflict and man's closeness to animals, struck a topical chord with the four judges (out of five) who gave it their votes. Renamed in its 34th year, the fiction prize's new sponsor is Man, a finance group. “Life of Pi”, published originally by Knopf of Canada, is available from Harcourt Brace in the United States and Canongate in Britain.

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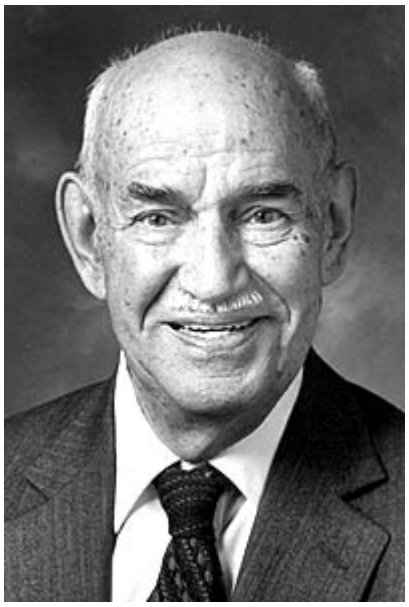
# Allen Read

Oct 24th 2002
From The Economist print edition

**Allen Walker Read, etymologist, died on October 16th, aged 96**

Columbia University



FOR much of his long career studying language Allen Read sought the origin of OK, perhaps the most useful expression of universal communication yet devised. You can use OK not simply to indicate agreement but, with appropriate facial expressions, shades of agreement, even disagreement. It is a vocabulary in itself. No wonder that OK has found its way into nearly every language in every country, and beyond. It was the fourth word, if you can call it that, heard on the moon, spoken by Buzz Aldrin. For etymologists, establishing the origin of OK became something of an obsession, equivalent to mathematicians' long quest for the proof to Fermat's last theorem.

For years Americans assumed that OK must be of American origin, if only because it was so successful. Some doubt about this claim arose in the second world war when American soldiers discovered that OK was already familiar in other countries; in Britain, of course, but in Japan and even (according to H.L. Mencken, an American writer on language) among the Bedouin in the Sahara.

Some linguists suggested that OK was of European origin. After all, the Europeans had been knocking around the world long before Americans got on to the scene. Germans said it was the initials of the fiercely-sounding rank of Oberst Kommandant. The French put in a claim for Aux Cayes, a town they had established in Haiti that produced superior rum. A British scholar said the use of OK in Britain predated any American influence and had probably come from Elizabethan English. Things were getting serious in the world of etymology. Step forward the Americans' champion, Allen Walker Read.

## Racy words

As early as he could remember Mr Read was interested in the origin of words. In Minnesota, where he was born, he sought the source of local place names, and wrote a paper on the subject while studying at Iowa University. He had a spell in England as a Rhodes scholar and returned to teach English at various universities in the mid-west. He sought words that he said had “a racy, human quality”, and there were none racier than the graffiti collected by Mr Read during a trip of several months through the western United States and Canada in the summer of 1928.

He put together the results of his trip in a book entitled, “Lexical Evidence from Epigraphy in Western North America: a Glossarial Study of the Low Element in the English Vocabulary”. Notwithstanding the academic title, the book contained material unacceptable for publication at the time in America. One of the milder entries, found by Mr Read on a monument, reads: “When you want to shit in ease/Place your elbows on your knees/Put your hands against your chin/Let a fart and then begin”. Mr Read had the book printed in Paris in 1935, perhaps encouraged that James Joyce had first published “Ulysses” there in the 1920s. Even so, only 75 copies of “Lexical Evidence” were printed and issued privately to “students of linguistics, folklore, abnormal psychology and allied branches of social sciences”. The book was published in the United States in 1977 as “Classic American Graffiti”.

Mr Read, who was professor of English at Columbia University in New York for nearly 30 years from 1945, published several other books and hundreds of papers, mainly on American English. Discovering the origin of OK was, he said, no more than an agreeable diversion from his main work. It was fun to do the research, helped by his wife Charlotte, a scholar in semantics. But for envious fellow etymologists it

was the pinnacle of his career.

In his hunt for the origin of OK he was offered dozens of theories. The first to go were the European ones. They were appealing: Mr Read liked what he called “frolicsome” ideas. But they had no substance, he said. He was convinced that OK was American. He warmed to the idea that the popularity of Orrin Kendall biscuits, supplied to soldiers on the Union side in the civil war, had lived on as OK. He noted there was a telegraph term known as Open Key. But OK proved to have been used much earlier. Writing in *American Speech* in 1963, Mr Read said that he had come across it in the Boston *Morning Post* in 1839. In what was apparently a satirical article about bad spelling it stood for “Oll Korrect”. The next stage in OK's popularity was when it was adopted by followers of Martin Van Buren, who in 1836 became the eighth president of the United States, and unsuccessfully stood for re-election in 1840, by which time he was widely known as Old Kinderhook, a nickname he derived from his home town. “Vote for OK” was snappier than using his Dutch name.

Mr Read showed how, stage by stage, OK was spread throughout North America and the world to the moon, and then took on its new form AOK, first used by space people and frowned on by purists. This being an exercise in the academic world, there remain some doubters. Some believe that the Boston newspaper's reference to OK may not be the earliest. Some are attracted to the claim that it is of American-Indian origin. There is an Indian word, *okeh*, used as an affirmative reply to a question. Mr Read treated such doubting calmly. “Nothing is absolute,” he once wrote, “nothing is forever.”

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# Overview

Oct 24th 2002
From The Economist print edition

Wall Street continued to rally. The Dow Jones Industrial Average rose by 5.7% over the week, despite further signs that **America's** recovery is stalling. The Conference Board's index of leading economic indicators fell in September for the fourth consecutive month. Yet a surge in imports shows that domestic spending remains strong: the visible-trade deficit widened to a record $42.3 billion in August; its 12-month deficit swelled to $447 billion.

The **yen** touched a four-month low of ¥125.6 to the dollar on concerns that measures to clean up the banking system might be delayed by political pressures. But the currency bounced back on October 23rd after Junichiro Koizumi, the prime minister, threw his weight behind the reforms.

**Inflation** slowed to 1.5% in America in the year to September, from 1.8% in August. **Canada's** inflation rate also declined to a lower-than-expected 2.3%, well within the Bank of Canada's target of 1-3%. This makes it less likely that the Bank will raise interest rates again at its next meeting in December. In contrast, **Australia's** inflation rate rose to 3.2% in the year to the third quarter, up from 2.8% in the second quarter. This left it slightly above the Reserve Bank's target of 2-3%.

There are yet more signs of economic weakness in the **euro area**. Industrial production fell by 0.8% in the 12 months to August. French household spending fell by 1.2% in September, reducing year-on-year growth to 1.5%. Excluding cars, spending fell by 2.2% in the month. The euro area's 12-month trade surplus widened to $89.5 billion in August, up from $12.8 billion a year earlier. This largely reflected a slump in imports—yet more evidence of weak domestic demand.

In their annual autumn report, **Germany's** six leading economic research institutes reduced their forecast for growth to only 0.4% this year and 1.4% in 2003. However, sluggish growth has done little to restrain wage inflation: German workers' pay rose by 2.7% in the year to August, up from 1.9% a year earlier and well ahead of the 1% inflation rate. Combined with sluggish productivity growth, rapid wage inflation is squeezing company profits.

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# Output, demand and jobs

Oct 24th 2002
From The Economist print edition

% change on year ago

| | GDP | | The Economist poll GDP forecasts | | Industrial production | Retail sales (volume) | Unemployment % rate | |
|---|---|---|---|---|---|---|---|---|
| | 1 qtr* | 1 year | 2002 | 2003 | latest | latest | latest | year ago |
| **Australia** | + 2.4 | + 3.8 Q2 | + 3.8 | + 3.5 | + 2.7 Q2 | + 6.3 Q2 | 6.2 Sep | 6.7 |
| **Austria** | na | + 0.4 Q2 | + 0.7 | + 1.9 | + 2.2 Jul | - 0.2 Jun | 4.2 Aug | 3.6 |
| **Belgium** | + 1.2 | + 0.3 Q2 | + 0.6 | + 2.0 | + 2.8 Aug | + 3.5 Jul | 12.0 Sep† | 11.7 |
| **Britain** | + 2.4 | + 1.3 Q2 | + 1.6 | + 2.7 | - 3.5 Aug | + 4.6 Sep | 5.2 Aug‡ | 5.1 |
| **Canada** | + 4.3 | + 3.2 Q2 | + 3.3 | + 3.3 | + 3.3 Jul | + 5.4 Jul | 7.7 Sep | 7.2 |
| **Denmark** | + 4.4 | + 2.0 Q2 | + 1.7 | + 2.1 | - 3.2 Aug | + 3.4 Aug | 5.1 Aug | 5.1 |
| **France** | + 1.6 | + 1.0 Q2 | + 1.1 | + 2.2 | - 1.1 Aug | - 1.5 Sep | 9.0 Aug†† | 8.7 |
| **Germany** | + 1.1 | + 0.1 Q2 | + 0.4 | + 1.6 | - 1.4 Aug | - 2.2 Aug | 9.8 Sep§ | 9.4 |
| **Italy** | + 0.9 | + 0.2 Q2 | + 0.5 | + 1.9 | - 7.0 Aug | - 1.4 Aug | 9.0 Jul | 9.5 |
| **Japan** | + 2.6 | - 0.7 Q2 | - 0.7 | + 1.0 | + 1.9 Aug | - 1.3 Aug | 5.4 Aug | 5.0 |
| **Netherlands** | + 0.5 | nil Q2 | + 0.6 | + 1.8 | - 2.0 Aug | + 2.0 Aug | 2.3 Sep** | 2.0 |
| **Spain** | + 1.8 | + 2.0 Q2 | + 1.9 | + 2.6 | - 3.9 Aug | na | 11.3 Aug | 10.6 |
| **Sweden** | + 2.4 | + 2.1 Q2 | + 1.8 | + 2.6 | - 0.4 Aug | + 2.1 Aug | 4.2 Sep† | 4.0 |
| **Switzerland** | + 0.4 | - 0.4 Q2 | + 0.3 | + 1.6 | - 2.0 Q2 | - 0.6 Aug | 2.8 Sep† | 1.7 |
| **United States** | + 1.3 | + 2.2 Q2 | + 2.4 | + 2.8 | + 0.4 Aug | + 6.1 Aug | 5.6 Sep | 5.0 |
| **Euro area** | + 1.6 | + 0.7 Q2 | + 0.8 | + 2.0 | - 0.8 Aug | + 1.4 Jul | 8.3 Aug | 8.0 |
| **MORE COUNTRIES** | Data for the countries below are not provided in printed editions of *The Economist* | | | | | | | |
| **Finland** | + 8.8 | + 2.5 Q2 | na | na | + 1.4 Aug | + 1.2 Jul | 8.1 Sep† | 8.7 |
| **Greece** | na | + 4.0 Q2 | na | na | + 1.5 Aug | na | na | na |
| **Iceland** | na | + 3.1 2001 | na | na | + 3.3 2001 | na | 2.2 Aug† | 1.1 |
| **Ireland** | na | + 2.9 Q1 | na | na | + 9.4 Aug | + 1.2 Aug | 4.3 Sep | 3.8 |
| **Luxembourg** | na | + 3.5 2001 | na | na | + 0.6 Jul | - 6.3 May | 2.8 Aug† | 2.4 |
| **New Zealand** | + 7.1 | + 4.0 Q2 | na | na | + 4.3 Q2 | + 8.3 Q2 | 5.1 Q2 | 5.3 |
| **Norway** | + 3.1 | + 1.7 Q2 | na | na | + 1.5 Aug | + 4.3 Sep | 3.8 Q2 | 3.6 |
| **Portugal** | + 1.4 | + 1.4 Q1 | na | na | - 0.7 Aug | + 1.9 Aug | 4.5 Q2† | 3.9 |

*% change at an annual rate. † Not seasonally adjusted. ‡ June-Aug; claimant count rate 3.1% in Sep. § EU harmonised rate 8.3% in Sep. **Jul-Sep. †† Revised series.

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# Prices and wages

Oct 24th 2002
From The Economist print edition

% change on year ago

| | Consumer prices | | | The Economist poll consumer prices forecast | | Producer prices | | | Wages/earnings | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | latest | | year ago | 2002 | 2003 | latest | | year ago | latest | | year ago |
| **Australia** | + 3.2 | Q3 | + 2.5 | + 2.8 | + 2.5 | – 1.1 | Q2 | + 5.6 | + 3.7 | Q2 | + 4.4 |
| **Austria** | + 1.6 | Sep | + 2.6 | + 1.7 | + 1.7 | – 0.1 | Sep | + 0.1 | + 2.3 | Aug | + 2.9 |
| **Belgium** | + 1.3 | Sep | + 2.3 | + 1.6 | + 1.5 | + 0.8 | Sep | – 1.0 | + 2.1 | Q3 | + 3.7 |
| **Britain** | + 1.7 | Sep | + 1.7 | + 1.9 | + 2.4 | + 0.4 | Sep | – 0.2 | + 3.8 | Aug | + 4.5 |
| **Canada** | + 2.3 | Sep | + 2.6 | + 2.0 | + 2.5 | + 0.4 | Aug | + 0.8 | + 3.0 | Jul | + 1.6 |
| **Denmark** | + 2.4 | Sep | + 2.3 | + 2.3 | + 2.0 | – 0.3 | Sep | + 0.7 | + 3.7 | Q2 | + 4.7 |
| **France** | + 1.8 | Sep | + 1.5 | + 1.8 | + 1.4 | – 0.2 | Aug | + 0.9 | + 3.8 | Q2 | + 4.2 |
| **Germany** | + 1.0 | Sep | + 2.1 | + 1.4 | + 1.1 | + 0.3 | Sep | – 0.2 | + 2.7 | Aug | + 1.9 |
| **Italy** | + 2.6 | Sep | + 2.6 | + 2.4 | + 1.9 | + 0.2 | Aug | + 1.2 | + 2.5 | Aug | + 2.5 |
| **Japan** | – 0.9 | Aug | – 0.7 | – 0.9 | – 0.6 | – 0.4 | Sep | – 0.3 | – 3.4 | Aug | – 1.3 |
| **Netherlands** | + 3.4 | Sep | + 4.7 | + 3.7 | + 2.4 | + 0.2 | Aug | + 1.8 | + 3.1 | Aug | + 5.0 |
| **Spain** | + 3.5 | Sep | + 3.4 | + 3.3 | + 2.6 | + 0.8 | Aug | + 1.6 | + 4.0 | Q2 | + 2.9 |
| **Sweden** | + 1.9 | Sep | + 3.2 | + 2.3 | + 2.0 | – 0.3 | Aug | + 1.5 | + 2.3 | Jul | + 2.6 |
| **Switzerland** | + 0.5 | Sep | + 0.7 | + 0.7 | + 1.0 | – 1.2 | Sep | – 0.9 | + 2.5 | 2001 | + 1.3 |
| **United States** | + 1.5 | Sep | + 2.6 | + 1.6 | + 2.2 | – 1.9 | Sep | + 1.6 | + 3.0 | Sep | + 4.1 |
| **Euro area** | + 2.1 | Sep | + 2.2 | + 2.2 | + 1.6 | – 0.2 | Aug | + 1.7 | + 3.3 | Q2 | + 3.0 |
| **MORE COUNTRIES** | Data for the countries below are not provided in printed editions of *The Economist* | | | | | | | | | | |
| **Finland** | + 1.0 | Sep | + 2.4 | na | na | – 0.8 | Sep | – 2.1 | + 3.8 | Q2 | + 4.9 |
| **Greece** | + 3.5 | Sep | + 3.6 | na | na | + 2.1 | Aug | + 2.1 | na | | na |
| **Iceland** | + 2.9 | Oct | + 8.0 | na | na | + 5.9 | Oct | + 6.8 | + 5.8 | Sep | + 9.1 |
| **Ireland** | + 4.5 | Sep | + 4.6 | na | na | – 0.8 | Aug | + 1.0 | + 4.3 | Q2 | + 8.5 |
| **Luxembourg** | + 2.0 | Sep | + 2.4 | na | na | – 1.0 | Jul | + 0.6 | – 1.7 | Jul | + 5.7 |
| **New Zealand** | + 2.6 | Q3 | + 2.4 | na | na | + 1.5 | Q2 | + 8.1 | + 2.1 | Q2 | + 1.8 |
| **Norway** | + 1.4 | Sep | + 2.4 | na | na | – 5.0 | Sep | +11.0 | + 4.9 | Q2 | + 4.4 |
| **Portugal** | + 3.7 | Sep | + 4.0 | na | na | – 1.8 | Aug | – 0.2 | – 0.2 | Jun | – 0.6 |

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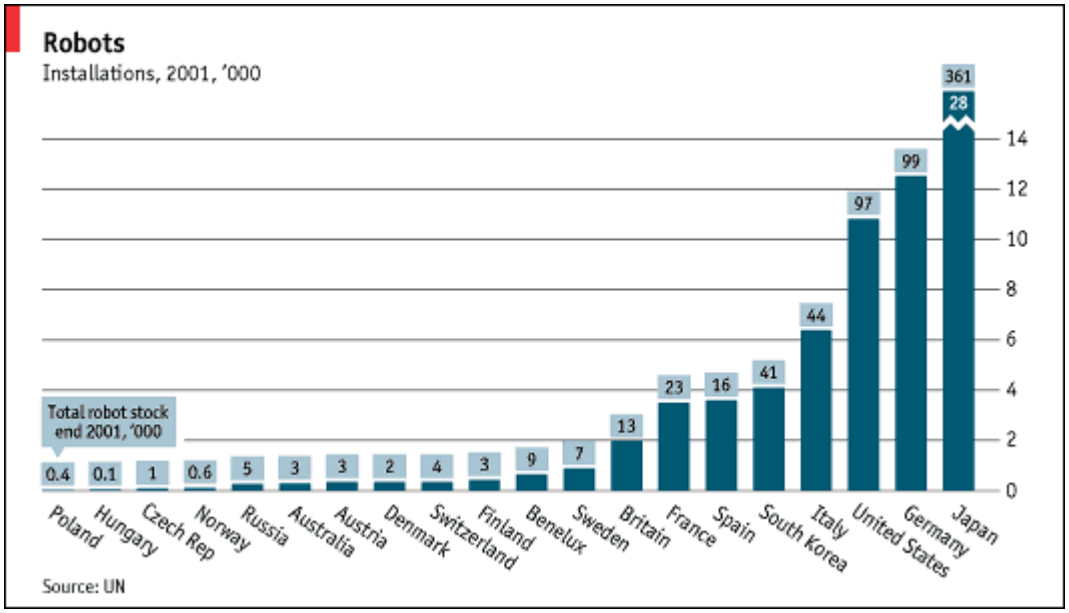
# Robots

Oct 24th 2002
From The Economist print edition




The number of new industrial robots installed in Japan dropped from 47,000 in 2000 to 28,300 last year. This dragged the global total down from 98,900 to 78,100. Although Japan's stock of robots also shrank, from 389,000 to 361,000, it is still almost half the world total. The United Nations World Robotics report estimates that global robot installations will rise by an average annual rate of 7.5% over the next four years.

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# Money and interest rates

Oct 24th 2002
From The Economist print edition

| | Money supply* % change on year ago | | | Interest rates % p.a. (Oct 23rd 2002) | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | 3-mth money market | | 2-year | 10-year gov't bonds | | corporate |
| | narrow | broad | | latest | year ago | gov't bonds | latest | year ago | bonds |
| **Australia** | – 4.2 | + 8.8 | Aug | 4.96 | 4.35 | 5.13 | 5.92 | 5.50 | 7.14 |
| **Britain** | + 8.2 | + 5.4 | Sep | 3.94 | 4.31 | 3.76 | 4.66 | 4.68 | 5.92 |
| **Canada** | +14.7 | + 6.6 | Sep | 2.79 | 2.53 | 3.54 | 5.30 | 5.20 | 7.24 |
| **Denmark** | + 7.4 | + 8.1 | Sep | 3.50 | 3.83 | 3.63 | 4.75 | 4.75 | 6.85 |
| **Japan** | +29.7 | + 3.3 | Sep | 0.02 | 0.01 | 0.00 | 1.07 | 1.32 | 1.16 |
| **Sweden** | + 2.4 | + 4.0 | Jun | 4.09 | 3.68 | 4.24 | 5.12 | 5.06 | 4.94 |
| **Switzerland** | +12.3 | + 6.8 | Sep | 0.77 | 2.21 | 0.95 | 2.70 | 2.96 | 4.00 |
| **United States** | – 0.6 | + 6.5 | Sep | 1.78 | 2.22 | 2.16 | 4.23 | 4.59 | 6.58 |
| **Euro area†** | + 7.8 | + 7.0 | Aug | 3.25 | 3.58 | 3.22 | 4.54 | 4.51 | 5.56 |

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 4.97%, Japan No.243 1.08%. Central bank rates: US fed funds 1.75%, ECB refinancing 3.25%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, DRI-WEFA, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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# The Economist commodity price index

Oct 24th 2002
From The Economist print edition

1995=100

| | Oct 15th | Oct 22nd* | % change on one month | % change on one year |
|---|---|---|---|---|
| **Dollar index** | | | | |
| All items | 75.7 | 75.5 | + 1.0 | +21.2 |
| Food | 80.8 | 80.4 | + 0.0 | +23.6 |
| Industrials | | | | |
| All | 68.8 | 68.9 | + 2.5 | +17.7 |
| Nfa† | 72.4 | 71.1 | + 1.1 | +29.0 |
| Metals | 65.7 | 67.0 | + 3.8 | + 9.1 |
| **Sterling index** | | | | |
| All items | 76.8 | 77.0 | + 1.7 | +11.3 |
| **Euro index** | | | | |
| All items | 101.3 | 101.6 | + 1.4 | +10.2 |
| **Yen index** | | | | |
| All items | 100.5 | 100.5 | + 2.4 | +23.3 |
| **Gold** | | | | |
| $ per oz | 315.50 | 312.85 | - 4.3 | +13.4 |
| **West Texas Intermediate** | | | | |
| $ per barrel | 29.77 | 27.87 | - 9.6 | +28.9 |

*Provisional. †Non-food agriculturals.

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# Stockmarkets

Oct 24th 2002
From The Economist print edition

Market indices

| | Oct 23rd | 2002 high | 2002 low | % change on one week | % change on record high | % change on Dec 31st 2001 in local currency | % change on Dec 31st 2001 in $ terms |
|---|---|---|---|---|---|---|---|
| Australia (All Ordinaries) | 2,987.2 | 3,440.0 | 2,855.5 | + 1.3 | -13.2 | -11.1 | - 3.9 |
| Austria (ATX) | 1,052.5 | 1,357.2 | 1,003.7 | + 2.1 | -39.4 | - 7.7 | + 1.3 |
| Belgium (Bel 20) | 1,991.1 | 2,899.8 | 1,773.7 | - 1.2 | -45.9 | -28.4 | -21.5 |
| Britain (FTSE 100) | 4,006.9 | 5,323.8 | 3,671.1 | - 1.3 | -42.2 | -23.2 | -18.4 |
| Canada (Toronto Composite) | 6,335.2 | 7,958.1 | 5,695.3 | + 2.9 | -44.4 | -17.6 | -16.0 |
| Denmark (KBX) | 165.8 | 233.4 | 156.4 | - 1.8 | -45.1 | -26.2 | -19.0 |
| France (SBF 250) | 2,011.7 | 3,081.9 | 1,794.5 | - 1.4 | -54.2 | -32.5 | -26.0 |
| (CAC 40) | 2,992.2 | 4,688.0 | 2,656.5 | - 2.5 | -56.8 | -35.3 | -29.0 |
| Germany (Xetra DAX) | 3,015.4 | 5,462.6 | 2,597.9 | + 0.2 | -62.6 | -41.6 | -35.9 |
| Italy (BCI) | 1,077.2 | 1,513.0 | 974.4 | + 1.0 | -50.6 | -24.9 | -17.5 |
| Japan (Nikkei 225) | 8,714.5 | 11,979.9 | 8,439.6 | - 1.9 | -77.6 | -17.3 | -13.4 |
| (Topix) | 866.1 | 1,139.4 | 835.6 | - 1.7 | -70.0 | -16.1 | -12.1 |
| Netherlands (AEX) | 329.3 | 531.2 | 291.4 | - 0.8 | -53.1 | -35.0 | -28.7 |
| Spain (Madrid SE) | 621.1 | 848.1 | 568.5 | + 0.7 | -45.8 | -24.7 | -17.3 |
| Sweden (Affarsvarlden Gen) | 139.7 | 236.8 | 122.7 | + 0.6 | -65.1 | -39.7 | -32.4 |
| Switzerland (Swiss Market) | 4,761.3 | 6,694.1 | 4,435.0 | - 3.3 | -43.4 | -25.8 | -18.1 |
| United States (DJIA) | 8,494.3 | 10,635.3 | 7,286.8 | + 5.7 | -27.5 | -15.2 | -15.2 |
| (S&P 500) | 896.1 | 1,172.5 | 776.8 | + 4.2 | -41.3 | -21.9 | -21.9 |
| (NASDAQ Comp) | 1,320.2 | 2,059.4 | 1,114.1 | + 7.1 | -73.8 | -32.3 | -32.3 |
| Europe (FTSE Eurotop 300)* | 873.8 | 1,279.7 | 797.2 | - 1.2 | -48.7 | -30.7 | -24.0 |
| Euro area (FTSE Ebloc 100)* | 718.1 | 1,125.1 | 639.4 | - 1.0 | -53.7 | -35.4 | -29.1 |
| World (MSCI)† | 786.8 | 1,024.4 | 703.7 | + 1.9 | -45.7 | na | -21.6 |
| World bond market (Salomon)‡ | 490.3 | 504.2 | 430.3 | - 0.3 | - 2.7 | na | +11.5 |

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms. ‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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# Trade, exchange rates and budgets

Oct 24th 2002
From The Economist print edition

| | Trade balance*, $bn latest 12 months | Current account $bn latest 12 mths | Current account The Economist poll % of GDP, forecast 2002 | Current account The Economist poll % of GDP, forecast 2003 | Exchange rate trade-weighted† 1990=100 Oct 23rd | Exchange rate trade-weighted† 1990=100 year ago | Currency units per $ Oct 23rd | Currency units per $ year ago | Currency units per £ | Currency units per euro | Currency units per ¥100 | Budget balance % of GDP 2002‡ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Australia | − 1.7 Aug | − 11.6 Q2 | − 3.7 | − 3.8 | 74.6 | 71.3 | 1.81 | 1.97 | 2.79 | 1.77 | 1.44 | 0.1 |
| Austria | − 1.1 Jul | − 1.0 Aug | − 1.6 | − 1.7 | 100.8§ | 100.3 | 1.02 | 1.12 | 1.58 | – | 0.82 | -0.3 |
| Belgium | + 16.6 Aug | + 12.5 Jun§ | + 5.0 | + 5.1 | 100.1§ | 99.1 | 1.02 | 1.12 | 1.58 | – | 0.82 | nil |
| Britain | − 44.2 Aug | − 25.8 Q2 | − 2.1 | − 2.0 | 106.5 | 104.9 | 0.65 | 0.70 | – | 0.63 | 0.52 | -0.8 |
| Canada | + 34.3 Aug | + 12.1 Q2 | + 2.0 | + 2.2 | 76.0 | 76.4 | 1.57 | 1.57 | 2.42 | 1.53 | 1.25 | 1.0 |
| Denmark | + 7.3 Aug | + 3.5 Aug | + 2.2 | + 2.0 | 103.0 | 102.6 | 7.61 | 8.33 | 11.8 | 7.43 | 6.08 | 2.2 |
| France | + 9.7 Aug | + 27.6 Aug | + 1.7 | + 1.6 | 103.0§ | 101.8 | 1.02 | 1.12 | 1.58 | – | 0.82 | -2.0 |
| Germany | +106.6 Aug | + 31.9 Aug | + 1.4 | + 1.1 | 99.9§ | 98.6 | 1.02 | 1.12 | 1.58 | – | 0.82 | -2.8 |
| Italy | + 10.6 Jul | − 3.1 Jul | nil | − 0.1 | 73.4§ | 72.7 | 1.02 | 1.12 | 1.58 | – | 0.82 | -1.4 |
| Japan | + 86.5 Aug | +114.0 Aug | + 2.8 | + 2.8 | 130.7 | 137.4 | 125 | 123 | 193 | 122 | – | -8.0 |
| Netherlands | + 26.0 Aug | + 2.7 Q2 | + 3.5 | + 3.6 | 99.1§ | 98.1 | 1.02 | 1.12 | 1.58 | – | 0.82 | 0.1 |
| Spain | − 36.4 Aug | − 14.5 Jul | − 1.9 | − 1.6 | 75.0§ | 74.3 | 1.02 | 1.12 | 1.58 | – | 0.82 | -0.3 |
| Sweden | + 14.5 Aug | + 7.9 Aug | + 3.3 | + 3.4 | 77.2 | 73.8 | 9.37 | 10.6 | 14.5 | 9.15 | 7.49 | 2.1 |
| Switzerland | + 3.8 Sep | + 22.7 Q2 | +10.1 | +10.3 | 114.2 | 111.4 | 1.50 | 1.66 | 2.33 | 1.47 | 1.20 | na |
| United States | −446.5 Aug | −428.8 Q2 | − 4.7 | − 4.9 | 115.1 | 119.6 | – | – | 1.55 | 0.98 | 0.80 | -1.0 |
| Euro area | + 89.5 Aug | + 27.5 Jul | + 0.5 | + 0.6 | 81.7 | 78.9 | 1.02 | 1.12 | 1.58 | – | 0.82 | -1.5 |
| MORE COUNTRIES | Data for the countries below are not provided in printed editions of *The Economist* | | | | | | | | | | | |
| Finland | + 13.0 Aug | + 9.4 Aug | na | na | 79.2§ | 78.4 | 1.02 | 1.12 | 1.57 | – | 0.81 | 3.2 |
| Greece | − 18.4 Jul | − 7.8 Jul | na | na | 58.0§ | 57.5 | 1.02 | 1.12 | 1.57 | – | 0.81 | 0.4 |
| Iceland | + 0.2 Aug | − 0.1 Q2 | na | na | 91.8** | 84.5 | 88.8 | 104.8 | 137 | 86.7 | 71.0 | -0.5 |
| Ireland | + 34.0 Jul | + 0.4 Q2 | na | na | 89.3§ | 87.6 | 1.02 | 1.12 | 1.57 | – | 0.81 | 0.1 |
| Luxembourg | − 2.9 Jul | + 2.1 Q2 | na | na | 100.1§ | 99.1 | 1.02 | 1.12 | 1.57 | – | 0.81 | 2.2 |
| New Zealand | − 0.1 Aug | − 1.3 Q2 | na | na | 89.2 | 80.1 | 2.07 | 2.39 | 3.20 | 2.02 | 1.65 | 0.1 |
| Norway | + 24.5 Sep | + 25.5 Jul | na | na | 105.2 | 96.9 | 7.59 | 8.91 | 11.7 | 7.42 | 6.07 | 14.0 |
| Portugal | − 12.8 Jul | − 9.4 Jul | na | na | 91.0** | 89.3 | 1.02 | 1.12 | 1.57 | – | 0.81 | -2.4 |

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, August average. ‡OECD forecast. **IMF, June average.

Text refers only to the first 16 countries listed

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# Trade-weighted exchange rates

Oct 24th 2002
From The Economist print edition

The 12 euro-area economies may have locked their exchange rates together, yet their trade-weighted exchange rates can still move apart. Ireland's trade-weighted rate has fallen further since 1999 because over 40% of its trade is with America or Britain.

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# Overview

Oct 24th 2002
From The Economist print edition

Factories in **Taiwan**, battered by the global economic slowdown, are getting busier. Industrial production rose by 12.5% in the year to September. In 2001 output fell by 7.3%.

Feeling the effects of its currency crisis, **Argentina's** industrial production fell by 4.5% in the year to September.

**Singapore's** consumer prices dropped by 0.4% in the 12 months to September. However, **Hong Kong's** price deflation is much worse, with prices falling by 3.7% over the same period.

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# The Economist poll of forecasters

Oct 24th 2002
From The Economist print edition

Every three months, *The Economist* polls a group of forecasters and averages their predictions for economic growth and current-account balances in 25 emerging economies. Our panel has become much gloomier over the past three months. Average forecasts for GDP growth in 2002 have been reduced in 19 out of the 25 economies. For 2003 our seers have cut their average growth forecast in all but two countries. Turkey is one of the exceptions where our forecasters have become more optimistic. Our panel now expects Turkey's GDP to grow by 4.1% in 2002, compared with a forecast of 2.5% in July. Argentina will see by far the biggest fall in output among emerging economies this year: its GDP is expected to shrink by 12.5%.

## The Economist poll of forecasters

October

| | Real GDP % change | | Current account % of GDP | |
|---|---|---|---|---|
| | 2002 | 2003 | 2002 | 2003 |
| China | 7.8 | 7.4 | 1.2 | 1.0 |
| Hong Kong | 1.6 | 3.0 | 9.4 | 9.3 |
| India | 4.8 | 5.8 | 0.2 | 0.1 |
| Indonesia | 3.6 | 4.0 | 3.7 | 3.6 |
| Malaysia | 4.0 | 4.9 | 7.0 | 6.8 |
| Philippines | 3.9 | 4.0 | 6.4 | 5.9 |
| Singapore | 3.5 | 4.1 | 21.0 | 19.6 |
| South Korea | 6.2 | 5.4 | 1.3 | 0.7 |
| Taiwan | 3.4 | 3.6 | 6.7 | 5.4 |
| Thailand | 4.3 | 4.2 | 4.5 | 4.1 |
| Argentina | −12.5 | 0.2 | 6.9 | 8.4 |
| Brazil | 1.2 | 2.2 | −3.4 | −2.8 |
| Chile | 2.3 | 4.0 | −1.2 | −1.3 |
| Colombia | 1.5 | 2.4 | −2.2 | −2.6 |
| Mexico | 1.5 | 3.4 | −2.8 | −3.1 |
| Peru | 2.3 | 2.9 | −0.8 | −1.1 |
| Venezuela | −5.2 | 0.6 | 3.9 | 3.5 |
| Egypt | 1.3 | 2.7 | −1.2 | −1.2 |
| Israel | −0.9 | 2.0 | −3.1 | −2.6 |
| South Africa | 2.5 | 2.9 | 0.2 | −0.2 |
| Turkey | 4.1 | 4.1 | −0.7 | −1.6 |
| Czech Republic | 2.6 | 3.6 | −4.0 | −4.2 |
| Hungary | 3.4 | 3.9 | −4.6 | −4.0 |
| Poland | 1.2 | 2.7 | −3.8 | −4.1 |
| Russia | 4.0 | 4.2 | 8.1 | 5.5 |

Sources: ABN Amro; Deutsche Bank; Economist Intelligence Unit; Goldman Sachs; HSBC; ING Financial Markets; J.P.Morgan Chase; Merrill Lynch; Salomon Smith Barney; UBS Warburg.

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# Economy

Oct 24th 2002
From The Economist print edition

| | % change on year ago | | | | | | Latest 12 months, $bn | | | | Foreign reserves* $bn, latest | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | GDP | | Industrial production | | Consumer prices | | Trade balance | | Current account | | | |
| China | + 8.1 | Q3 | +13.8 | Sep | – 0.7 | Sep | +29.1 | Sep | +17.4 | 2001 | 258.6 | Sep |
| Hong Kong | + 0.5 | Q2 | –11.2 | Q2 | – 3.7 | Sep | – 8.4 | Aug | +15.7 | Q2 | 111.2 | Sep |
| India | + 6.0 | Q2 | + 5.7 | Aug | + 3.9 | Aug | – 5.1 | Aug | + 2.0 | Q2 | 59.5 | Sep |
| Indonesia | + 3.5 | Q2 | –13.8 | Q1 | +10.1 | Sep | +26.6 | Aug | + 6.1 | Q1 | 29.3 | Aug |
| Malaysia | + 3.8 | Q2 | + 5.9 | Aug | + 2.1 | Sep | +12.8 | Aug | + 6.9 | Q2 | 33.0 | Aug |
| Philippines | + 4.5 | Q2 | + 6.4 | Jul | + 2.9 | Sep | + 2.6 | Aug | + 6.3 | Jun | 13.2 | Sep |
| Singapore | + 3.7 | Q3 | +15.8 | Aug | – 0.4 | Sep | + 6.9 | Aug | +17.5 | Q2 | 80.7 | Sep |
| South Korea | + 6.3 | Q2 | + 8.5 | Aug | + 3.1 | Sep | + 9.9 | Sep | + 5.5 | Aug | 116.0 | Sep |
| Taiwan | + 3.0 | Q2 | +12.5 | Sep | – 0.7 | Sep | +18.2 | Sep | +24.8 | Q2 | 156.4 | Aug |
| Thailand | + 5.1 | Q2 | +11.4 | Aug | + 0.4 | Sep | + 3.4 | Aug | + 6.3 | Aug | 37.7 | Aug |
| Argentina | –13.6 | Q2 | – 4.5 | Sep | +38.5 | Sep | +14.1 | Aug | + 3.9 | Q2 | 9.2 | Aug |
| Brazil | + 1.0 | Q2 | + 0.9 | Aug | + 7.9 | Sep | + 9.9 | Sep | –15.2 | Aug | 37.6 | Aug |
| Chile | + 1.7 | Q2 | – 1.0 | Aug | + 2.3 | Sep | + 2.2 | Sep | – 0.6 | Q2 | 14.9 | Aug |
| Colombia | + 2.2 | Q2 | + 2.7 | Jul | + 6.0 | Sep | + 0.5 | Jul | – 1.4 | Q1 | 10.6 | Aug |
| Mexico | + 2.1 | Q2 | + 0.7 | Aug | + 5.0 | Sep | – 8.9 | Sep | –16.3 | Q2 | 46.5 | Aug |
| Peru | + 3.8 | Aug | + 4.8 | Aug | + 0.7 | Sep | + 0.2 | Aug | – 1.0 | Q2 | 9.5 | Aug |
| Venezuela | – 9.9 | Q2 | – 6.6 | Jul | +28.2 | Sep | + 8.5 | Q2 | + 1.9 | Q2 | 8.2 | Jul |
| Egypt | + 4.9 | 2001† | + 7.8 | 2001† | + 2.7 | Aug | – 7.9 | Jun | nil | Q2 | 13.0 | Jun |
| Israel | – 1.7 | Q2 | – 2.8 | Aug | + 6.4 | Sep | – 6.2 | Aug | – 2.6 | Q2 | 24.6 | Sep |
| South Africa | + 2.2 | Q2 | + 8.2 | Aug | +12.5 | Sep | + 3.4 | Aug | – 0.3 | Q2 | 6.0 | Aug |
| Turkey | + 8.2 | Q2 | + 7.2 | Aug | +37.0 | Sep | –10.9 | Jul | + 1.5 | Jul | 25.1 | Aug |
| Czech Republic | + 2.5 | Q2 | – 2.8 | Aug | + 0.8 | Sep | – 3.1 | Sep | – 2.3 | Q2 | 22.3 | Sep |
| Hungary | + 3.1 | Q2 | – 0.9 | Aug | + 4.6 | Sep | – 2.6 | Aug | – 2.4 | Aug | 10.3 | Aug |
| Poland | + 0.8 | Q2 | + 6.7 | Sep | + 1.3 | Sep | –10.3 | Aug | – 6.4 | Aug | 28.2 | Sep |
| Russia | + 4.1 | Q2 | + 5.5 | Sep | +15.0 | Sep | +42.6 | Aug | +28.3 | Q2 | 41.9 | Sep |
| **MORE COUNTRIES** | Data for the countries below are not provided in printed editions of *The Economist* | | | | | | | | | | | |
| Pakistan | + 3.3 | 2001† | + 2.8 | May | + 3.7 | Sep | – 1.1 | Sep | + 2.7 | 2002† | 4.8 | Jun |
| Saudi Arabia | + 1.2 | 2001 | na | | – 0.2 | Apr | +44.1 | 2001 | +14.5 | 2001 | 17.7 | Aug |

*Excluding gold, except Singapore; IMF definition. †Year ending June.

**Text refers only to the first 25 countries listed**

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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# Financial markets

Oct 24th 2002
From The Economist print edition

| | Currency units | | | Interest rates | Stockmarkets | % change on | | |
|---|---|---|---|---|---|---|---|---|
| | per $ | | per £ | short-term | Oct 23rd | | Dec 31st 2001 | |
| | Oct 23rd | year ago | Oct 23rd | % p.a. | | one week | in local currency | in $ terms |
| China | 8.28 | 8.28 | 12.8 | na | 1,617.0 | +0.8 | – 5.6 | – 5.6 |
| Hong Kong | 7.80 | 7.80 | 12.1 | 2.16 | 9,804.7 | +3.7 | – 14.0 | – 14.0 |
| India | 48.3 | 48.0 | 74.7 | 5.72 | 2,949.0 | –1.5 | – 9.6 | – 9.8 |
| Indonesia | 9,215 | 10,230 | 14,254 | 13.94 | 354.9 | –0.7 | – 9.5 | + 2.2 |
| Malaysia | 3.80 | 3.80 | 5.88 | 3.10 | 652.8 | +2.9 | – 6.2 | – 6.2 |
| Philippines | 53.0 | 51.9 | 82.0 | 6.88 | 1,012.9 | –3.4 | – 13.3 | – 15.6 |
| Singapore | 1.78 | 1.83 | 2.75 | 1.06 | 1,463.3 | +1.7 | – 9.9 | – 6.4 |
| South Korea | 1,227 | 1,294 | 1,898 | 4.94 | 657.4 | +3.3 | – 5.2 | + 1.5 |
| Taiwan | 34.8 | 34.5 | 53.8 | 2.10 | 4,589.9 | +8.7 | – 17.3 | – 16.9 |
| Thailand | 43.6 | 44.8 | 67.4 | 1.94 | 346.2§ | +4.0 | + 13.9 | + 15.6 |
| Argentina | 3.60 | 1.00 | 5.56 | 19.00 | 433.8 | –1.0 | + 46.9 | – 59.2 |
| Brazil | 3.88 | 2.74 | 6.00 | 17.90 | 9,840.0 | +17.6 | – 27.5 | – 56.8 |
| Chile | 736 | 713 | 1,138 | 2.76 | 4,682.0 | +2.1 | – 13.3 | – 22.1 |
| Colombia | 2,751 | 2,319 | 4,256 | 7.84 | 1,328.6 | +2.8 | + 24.1 | + 2.7 |
| Mexico | 10.01 | 9.22 | 15.5 | 7.33 | 6,000.6 | +1.3 | – 5.8 | – 13.7 |
| Peru | 3.61 | 3.45 | 5.58 | 4.18 | 1,199.4 | +1.5 | + 2.0 | – 2.7 |
| Venezuela | 1,421 | 743 | 2,198 | 30.26 | 7,772.7 | +3.5 | + 18.3 | – 36.9 |
| Egypt | 4.63 | 4.26 | 7.17 | 6.69 | 5,210.2 | +0.3 | – 1.2 | – 2.4 |
| Israel | 4.73 | 4.31 | 7.32 | 6.40 | 328.6 | +1.0 | – 26.5 | – 31.5 |
| South Africa | 10.2 | 9.38 | 15.7 | 13.55 | 9,718.4 | +1.6 | – 6.9 | + 9.7 |
| Turkey | 1,668,950 | 1,612,500 | 2,581,532 | 42.00 | 9,943.6 | +8.2 | – 27.9 | – 37.1 |
| Czech Republic | 31.7 | 37.4 | 49.0 | 2.80 | 432.8 | +2.6 | + 9.7 | + 23.2 |
| Hungary | 248 | 283 | 383 | 9.68 | 7,199.6§ | +3.7 | + 1.0 | + 12.0 |
| Poland | 4.11 | 4.12 | 6.36 | 7.40 | 13,739.8 | +2.9 | – 1.3 | – 5.1 |
| Russia | 31.7 | 29.6 | 49.1 | 21.00 | 357.5‡ | +1.4 | + 43.1 | + 37.5 |
| EMF (MSCI)* | 1.00 | 1.00 | 1.55 | na | 280.0 | +4.7 | na | – 15.0 |
| EMBI+† | 1.00 | 1.00 | 1.55 | na | 208.9 | +2.7 | na | + 4.3 |

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. §Oct 22nd. ‡In $ terms.
Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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